INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS

Public

INSURANCE CORE PRINCIPLES

UPDATED NOVEMBER 2018

The Insurance Core Principles were initially adopted on 1 October 2011.
Since then, amendments have been made to the following ICPs:

- ICP 9 October 2012
- ICP 22 October 2013
- ICPs 4, 5, 7, 8, 23 and (parts of) 25 November 2015
- ICPs 13, 18 and 19 November 2017
- ICP 6 November 2018

About the IAIS

The International Association of Insurance Supervisors (IAIS) is a voluntary membership organisation of insurance supervisors and regulators from more than 200 jurisdictions. The mission of the IAIS is to promote effective and globally consistent supervision of the insurance industry in order to develop and maintain fair, safe and stable insurance markets for the benefit and protection of policyholders and to contribute to global financial stability.

Established in 1994, the IAIS is the international standard setting body responsible for developing principles, standards and other supporting material for the supervision of the insurance sector and assisting in their implementation. The IAIS also provides a forum for Members to share their experiences and understanding of insurance supervision and insurance markets.

The IAIS coordinates its work with other international financial policymakers and associations of supervisors or regulators, and assists in shaping financial systems globally. In particular, the IAIS is a member of the Financial Stability Board (FSB), member of the Standards Advisory Council of the International Accounting Standards Board (IASB), and partner in the Access to Insurance Initiative (A2ii). In recognition of its collective expertise, the IAIS also is routinely called upon by the G20 leaders and other international standard setting bodies for input on insurance issues as well as on issues related to the regulation and supervision of the global financial sector.

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A) Introduction

1. A sound regulatory and supervisory system is necessary for maintaining a fair, safe and stable insurance[1] sector for the benefit and protection of the interests of policyholders, beneficiaries and claimants (collectively referred to as policyholders in this document) as well as contributing to the stability of the financial system.

2. The insurance industry, like other components of the financial system, is changing in response to a wide range of social, technological and global economic forces. Insurance supervisory systems and practices must be continually upgraded to cope with these developments. Insurance and other financial sector supervisors and regulators should understand and address financial and systemic stability concerns arising from the insurance sector as they emerge and their interaction with other financial sectors.

3. The nature of insurance activity - covering risks for the economy, financial and corporate undertakings and households - has both differences and similarities when compared to the other financial sectors. Insurance, unlike most financial products, is characterised by the reversal of the production cycle insofar as premiums are collected when the contract is entered into and claims arise only if a specified event occurs. Insurers intermediate risks directly. They manage these risks through diversification and risk pooling enhanced by a range of other techniques.

4. In addition to business risks, significant risks to insurers are generated on the liability side of the balance sheet. These risks are referred to as technical risks and relate to the actuarial and/or statistical calculations used in estimating liabilities, and other risks associated with such liabilities. Insurers incur market, credit, liquidity and operational risk from their investments and financial operations, including risks arising from asset-liability mismatches. Life insurers also offer products of life cover with a savings content and pension products that are usually managed with a long-term perspective. The regulatory and supervisory system must address all these risks.

5. Finally, the regulatory and supervisory system must address the increasing presence in the market of insurance groups and financial conglomerates, as well as financial convergence. The importance of the insurance sector for financial stability matters has been increasing which has implications for insurance supervision[2] as it requires more focus on a broad set of risks. Supervisors at a jurisdictional and international level must collaborate to ensure that these entities are effectively supervised so that policyholders are protected and financial markets remain stable; to minimise the risk of contagion from one sector or jurisdiction to another; and to reduce supervisory gaps and avoid unnecessary supervisory duplication.

[1] Insurance refers to the business of insurers and reinsurers, including captives.
[2] Supervision refers to both regulation and supervision. Supervisors include regulators.

Scope and coverage of the Insurance Core Principles

6. The *Insurance Core Principles* (ICPs) provide a globally accepted framework for the supervision of the insurance sector. The ICP material is presented according to a hierarchy of supervisory material. The ICP statements are the highest level in the hierarchy and prescribe the essential elements that must be present in the supervisory regime in order to promote a financially sound insurance sector and provide an adequate level of policyholder protection. Standards are the next level in the hierarchy and are linked to specific ICP statements. Standards set out key high level requirements that are fundamental to the implementation of the ICP statement and should be met for a supervisory authority to demonstrate observance with the particular ICP. Guidance material is the lowest level in the hierarchy and typically supports the ICP statement and/or standards. Guidance material provides detail on how to implement an ICP statement or standard. Guidance material does not prescribe new requirements but describes what is meant by the ICP statement or standard and, where possible, provides examples of ways to implement the requirements.

7. The ICP material is presented in order that the hierarchy can be clearly understood, as follows:

- ICP statements – numbered and presented in a box with bold font
- Standards – linked to an ICP statement and presented in bold font, with the number of the applicable principle statement followed by the standard number. e.g. the second standard under ICP statement 3 appears as 3.2
- Guidance material – linked to a particular ICP statement and/or standard. Guidance material is presented in regular font, with the number of the ICP statement and standard followed by the guidance number, e.g. the second paragraph of guidance under Standard 1.3 appears as 1.3.2.

8 The ICPs apply to insurance supervision in all jurisdictions regardless of the level of development or sophistication of the insurance markets and the type of insurance products or services being supervised. Nevertheless, supervisory measures should be appropriate to attain the supervisory objectives of a jurisdiction and should not go beyond what is necessary to achieve those objectives. It is recognised that supervisors need to tailor certain supervisory requirements and actions in accordance with the nature, scale and complexity of individual insurers. In this regard, supervisors should have the flexibility to tailor supervisory requirements and actions so that they are commensurate with the risks posed by individual insurers as well as the potential risks posed by insurers to the insurance sector or the financial system as a whole. This is provided for in the ICPs and standards where relevant.

9. The ICPs apply to the supervision of all insurers whether private or government-controlled insurers that compete with private enterprises, wherever their business is conducted, including through e-commerce. Where the principles do not apply to reinsurers, this is indicated in the text. The ICPs do not normally apply to the supervision of intermediaries but where they do, this is specifically indicated.

10. Insurance supervision within an individual jurisdiction may be the responsibility of more than one authority. For example, the body that sets out the legal framework for insurance supervision may be different from the body that implements it. The expectation is that the ICPs are applied within the jurisdiction by all authorities in accordance with their respective responsibility in relation to the supervision of the insurance sector (referred to as "the supervisor") rather than necessarily by only one authority. It is, however, essential that in situations where multiple authorities exist, coordination arrangements be established between them to ensure that the implementation of the ICPs within the jurisdiction occurs in an accountable framework.

11. The supervisor must operate in a transparent and accountable manner. It needs legal authority to perform its tasks. It should be noted, however, that the possession of legal authority is not sufficient to demonstrate observance with an ICP: the supervisor should also demonstrate that it is able to exercise its legal authority in practice. Similarly, it is not sufficient for the supervisor to set supervisory requirements; it should also ensure that these requirements are implemented. Having the necessary resources and capacity is essential for the supervisor to effectively exercise its legal authority and implement supervisory requirements.

12. The supervisor must recognise that transparency and accountability in all its functions contribute to its legitimacy and credibility. A critical element of transparency is for the supervisor to provide the opportunity for meaningful public consultation on the development of supervisory policies, and in the establishment of new and amended rules and regulations. To further ensure the proper functioning of the insurance sector and promote transparency and accountability, the supervisor should establish clear timelines for public consultation and action, where appropriate.

Application of ICPs and standards to group-wide supervision

13. For the purpose of these ICPs, the term "insurer" means insurance legal entities, insurance groups and insurance-led financial conglomerates. The ICPs and standards apply to the supervision of insurance legal entities and, unless otherwise specified, to insurance groups and insurance-led financial conglomerates, including the head of the insurance group and/or the head of the insurance-led financial conglomerate. The application may vary and, where necessary, further guidance is provided.

14. It is recognised that the implementation of the ICPs and standards relevant to group-wide supervision may vary across jurisdictions depending on the supervisory powers and structure within a jurisdiction. There are direct and indirect approaches to group-wide supervision. Under the direct approach, the supervisor has the necessary powers over the parent and other entities in the insurance group and can impose relevant supervisory measures directly on such entities, including non-regulated entities. Under the indirect approach, supervisory powers focus on the insurance legal entities and supervisory measures are applied to those insurance legal entities to address the group-wide risks posed by other entities within the group, including non-regulated entities. There may also be different combinations of elements of the direct and indirect approaches.

15. Regardless of the approach, the supervisor must be able to demonstrate that in effect, the outcome is similar to having the supervisory requirements applied directly on those entities within the insurance group from which the risks are emanating. This is to ensure effective group-wide supervision, which includes ensuring that all relevant group-wide risks impacting the insurance entities are addressed appropriately.

Implementation and assessment

16. The ICPs can be used to establish or enhance a jurisdiction's supervisory system. They can also serve as the basis for assessing the existing supervisory system and in so doing may identify weaknesses, some of which could affect policyholder protection and market stability. The Assessment Methodology sets out factors that should be considered when using or implementing these ICPs and describes how observance should be evaluated.

17. When implementing the ICPs and standards in a jurisdiction, it is important to take into account the domestic context, industry structure and developmental stage of the financial system and overall macroeconomic conditions. The methods of implementation will vary across jurisdictions, and while established implementation practices should be kept in mind, there is no mandated method of implementation. In the ICPs, the term "legislation" is used to include both primary legislation (which generally requires full legislative consent) and secondary and other forms of legislation, including rules and regulations which have the legal force of law but are usually the responsibility of the supervisor.

18. For an ICP to be regarded as being "observed" by a jurisdiction, the standards must be met without any significant shortcomings although there may be instances, where one can demonstrate that the ICPs have been observed through different means other than those identified in the standards. Conversely, owing to the specific conditions in individual jurisdictions, the standards identified in this document may not always be sufficient to achieve the objective of the specific ICP and therefore additional elements may have to be taken into account.

Preconditions for effective insurance supervision

19. An effective system of insurance supervision needs a number of external elements, or preconditions, on which to rely as they can have a direct impact on supervision in practice. The preconditions include:

- sound and sustainable macroeconomic and financial sector policies;
- a well developed public infrastructure;
- effective market discipline in financial markets;
- mechanisms for providing an appropriate level of protection (or public safety net); and
- efficient financial markets.

20. As these preconditions are normally outside the control or influence of the supervisor, the supervisor should not be assessed against these preconditions. However, the preconditions can have a direct impact on the effectiveness of supervision in practice. Therefore, where shortcomings exist, the supervisor should make the government aware of these and their actual or potential negative repercussions for the supervisory objectives and should seek to mitigate the effects of such shortcomings on the effectiveness of supervision. The supervisor should have the necessary powers to make rules and establish procedures to address shortcomings. Where the preconditions for effective insurance supervision are not yet met, the supervisor should have additional powers or adopt other measures to address the weaknesses.

21. Sound macroeconomic policies must be the foundation of a stable financial system. This is not within the mandate of supervisors, although they will need to react if they perceive that existing policies are undermining the safety and soundness of the financial system. In addition, financial sector supervision needs to be undertaken within a transparent government policy framework aimed at ensuring financial stability, including effective supervision of the insurance and other financial sectors.

22. A well developed public infrastructure needs to comprise the following elements, which if not adequately provided, can contribute to the weakening of financial systems and markets or frustrate their improvement:

- a system of business laws, including corporate, insolvency, contract, consumer protection and private property laws, which is consistently enforced and provides a mechanism for the fair resolution of disputes;
- an efficient and independent judiciary;
- comprehensive and well defined accounting principles and rules that command wide international acceptance;
- a system of independent audits for companies, to ensure that users of financial statements, including insurers, have independent assurance that the accounts provide a true and fair view of the financial position of the company and are prepared according to established accounting principles, with auditors held accountable for their work;
- the availability of skilled, competent, independent and experienced actuaries, accountants and auditors, whose work complies with transparent technical and ethical standards set and enforced by official or professional bodies in line with international standards and is subject to appropriate oversight;
- well defined rules governing, and adequate supervision of, other financial sectors and, where appropriate, their participants;
- a secure payment and clearing system for the settlement of financial transactions where counterparty risks are controlled; and
- the availability (to the supervisor, financial services and public) of basic economic, financial and social statistics.

23. Effective market discipline depends, in part, on adequate flows of information to market participants, appropriate financial incentives to reward well managed institutions, and arrangements that ensure that investors are not insulated from the consequences of their decisions. Among the issues to be addressed are the existence of appropriate corporate governance frameworks and ensuring that accurate, meaningful, transparent and timely information is provided by borrowers to investors and creditors.

24. In general, deciding on the appropriate level of policyholder protection is a policy question to be addressed by the relevant authorities, particularly if it may result in a commitment of public funds. Supervisors will normally have a role to play because of their in-depth knowledge of the entities involved. They should be prepared, as far as possible, and equipped to manage crises involving insurers. Such mechanisms of protection could include a system of policyholder compensation in the event of insolvency of an insurer. Provided such a system is carefully designed to limit moral hazard, it can contribute to public confidence in the system.

25. Efficient financial markets are important to provide for both long-term and short-term investment opportunities for insurers. They facilitate the assessment of the financial and risk position of insurers and execution of their investment and risk management strategies. When the financial market loses its efficiency, assessment of financial and risk positions can be more challenging for both insurers and supervisors. Therefore, supervisors will need to give due consideration to the impact of financial market efficiency on the effectiveness of their supervisory measures.

B) Assessment Methodology

Review of preconditions for effective insurance supervision

1. The review of preconditions should include an overview of the preconditions for effective insurance supervision, as described in paragraphs 19 to 25 of the Introduction:

- sound and sustainable macroeconomic and financial sector policies;
- a well developed public infrastructure;
- effective market discipline in financial markets;
- mechanisms for providing an appropriate level of systemic protection (or public safety net); and
- efficient financial markets.

2. The review should pay close attention to the adequacy of preconditions and provide a succinct and well structured factual summary, following the headings indicated in paragraph 1 above. This review should give a clear picture of the interaction of the preconditions with the assessment of observance with the ICPs which should flag the individual ICPs which are most likely to be affected by any material weakness in the preconditions.

3. The review should not evaluate a jurisdiction's observance of the preconditions, as this is beyond the scope of the assessment of observance with the ICPs. Instead, the objective of the review of preconditions is to inform the assessment of the ICPs. The report normally should take up no more than one or two paragraphs for each type of precondition. Assessors may rely to the extent possible on IMF, World Bank and other official documents that assess the issues covered by the preconditions[3].

4. In particular, with regard to the presence of sound and sustainable macroeconomic policies, the report on the preconditions should be descriptive, and should not express an opinion on the adequacy of policies in these areas, other than through reference to analyses and recommendations in existing official documents. When relevant, the review should attempt to include an analysis of the linkages between these factors and the stability of the insurance sector.

5. The review should also include a review of the relevant government financial sector policies, including whether there is a clear and published framework assigning responsibility to different bodies involved in financial stability and supervisory work.

[3] In the context of a Financial Sector Assessment Program (FSAP), assessors should rely on IMF and World Bank documents and should seek to ensure that the description and recommendations are consistent with other IMF and World Bank positions on the issues.

6. A factual review of the public infrastructure should focus on elements relevant to the insurance sector.

7. The review of the effectiveness of market discipline could, for instance, cover issues such as the presence of rules on corporate governance, transparency and audited financial disclosure, appropriate incentive structures for the hiring and removal of managers and Board members, protection of shareholders' and other stakeholders' rights, adequate availability of market and consumer information, an effective framework for new entrants, mergers, takeovers, and acquisition of equity interests, including those involving foreign entities.

8. An overview of the appropriateness of safety nets could, for instance, include the following elements: an analysis of the functions of the various entities involved such as supervisors, the policyholder protection fund and, if appropriate, the central bank. The review should include a review of the extent to which supervisors are prepared and equipped to manage crises involving one or more insurers, including whether simulation exercises are undertaken and the availability of appropriate skills and adequate resources. The review should also include a review of any arrangements for the use of public funds (including central bank funds) and whether measures are in place to minimise moral hazard.

9. The overview of whether there are efficient financial markets could cover, for example, the range of instruments and issuers (e.g. is there a spread of public sector issues, index-linked as well as conventional government bonds) and the spread of available maturities. The review could take note of how liquidity has been affected in markets in periods of stress. The review should focus on relevant issues for the carrying on of insurance business, taking into account the products offered, for example, whether annuities or other long term contracts of insurance are provided.

Assessment of ICPs

10. The factors that should be considered when carrying out an assessment of a jurisdiction or authority's observance of the ICPs and standards are set out below. When carrying out an assessment of observance, it is important to take into account the domestic context, industry structure and developmental stage of the financial system and overall macroeconomic conditions.

11. The IAIS strongly encourages implementation of the framework for effective supervision described by the ICPs. Assessments can facilitate implementation by identifying the extent and nature of any weaknesses in a jurisdiction's supervisory framework – especially those aspects that could affect policyholder protection and insurance sector stability – as well as recommending possible remedies.

12. The framework described by the ICPs is general. Supervisors have flexibility in determining the specific methods for implementation which are tailored to their domestic context (e.g. legal and market structure). The standards set requirements that are fundamental to the implementation of each ICP. They also facilitate assessments that are comprehensive, precise and consistent. While the results of the assessments may not always be made public, it is still important for their credibility that they are conducted in a broadly uniform manner from jurisdiction to jurisdiction.

Scope

13. Assessments against the ICPs can be conducted in a number of contexts including:

- self assessments, on either the full set of ICPs or against specific ICPs, performed by insurance supervisors themselves, sometimes with the assistance of other experts. Self assessments may be followed by peer review and analysis.
- reviews conducted by third parties
- reviews conducted in the context of the IMF and World Bank Financial Sector Assessment Program (FSAP).

14. Normally, but not always, the ICPs should be equally applicable to both life and non-life sectors in order for an overall rating to be assigned. Similarly, it is possible that certain specialised parts of the insurance sector would have observance with the ICPs differing from the other insurance business in the jurisdiction. Where the legal or practical position is materially different between life and non-life insurance or with respect to specialised parts of the insurance business in the jurisdiction such that it would give rise to a different rating had the assessments been carried out separately, it is open to the assessor to consider assigning a level of observance separately for the two parts of the insurance sector for that particular principle. In such cases, the distinction should be clearly identified in the report.

15. Generally, an assessment should be conducted on a system-wide jurisdictional basis. However, follow-up assessments could focus on identified weaknesses or areas of particular risk. Full FSAP reviews are always done with respect to the jurisdiction as a whole. Where more than one authority is involved in the supervisory process, the interaction of supervisory roles should be clearly described in the assessment. If an assessment is conducted in the context of an individual supervisor, a standard may be assessed as **not applicable** if the responsibility lies with another authority within the jurisdiction. However, the authority responsible for the observance of that standard should be indicated in the report.

Conduct of independent assessments - assessment by experts

16. The process of assessing each ICP requires a judgmental weighing of numerous elements that only qualified assessors with practical and relevant experience can provide. Assessors not familiar with the insurance sector could come to incorrect or misleading conclusions due to their lack of sector specific knowledge. Therefore, independent

assessments should only be conducted by those with relevant background and professional experience.

Conduct of independent assessments - access to information

17. When conducting an independent assessment, prior consent from the relevant local authorities is required so that assessors can have access to a range of information and people. The required information may include not only published information such as the legislation and administrative policies but also non-published information, such as self-assessments, operational guidelines for insurance supervisors and the like. The information should be provided as long as it does not violate confidentiality requirements. This information should be provided and analysed in advance to the extent possible, in order to ensure that subsequent on-site visits are efficient and derive the most value. The assessor will need to meet with various individuals and organisations, including the insurance supervisor or supervisors, other domestic supervisory authorities, any relevant government ministries, insurers and insurance industry associations, actuaries, auditors, and other financial sector participants.

Assessment Categories

Assessment of standards

18. In making the assessment, each of the **standards** has to be considered. The standards should be assessed using five categories: **observed, largely observed, partly observed, not observed,** and **not applicable**.

19. For a standard to be considered **observed** it is usually necessary that the supervisor has the legal authority to perform its tasks and that it exercises this authority to a satisfactory level. Where the supervisor sets requirements it should also ensure that these requirements are implemented. Having the necessary resources is essential for the supervisor to effectively implement the requirements. Authority provided in the legislation is insufficient for full observance to be recorded against a standard except where the standard is specifically limited in this respect. In the event that the supervisor has a history of using a practice for which it has no explicit legal authority, the assessment may be considered as observed if the practice is clearly substantiated as common and generally accepted.

20. Assessments are based solely on the legislation and other supervisory requirements and practices that are in place at the time. Nevertheless, improvements already proposed by the supervisor can be noted in the assessment report by way of additional comments so as to give credit for efforts that are important but at the time the assessment is made, have yet to be fully implemented. Similarly, legislation that does not meet with a satisfactory level of observance in practice cannot provide the basis for recording a standard as “observed”. As a

result, it is important to recognise when the assessment is conducted and to record this in the report.

21. For a standard to be considered as **largely observed,** it is necessary that only minor shortcomings exist which do not raise any concerns about the supervisor's ability to achieve full observance with the standard. A standard will be considered **partly observed** whenever, despite progress, the shortcomings are sufficient to raise doubts about the supervisor's ability to achieve observance. A standard will be considered **not observed** whenever no substantive progress toward observance has been achieved.

22. A standard would be considered **not applicable** if the standard does not apply given the structural, legal and institutional features of a jurisdiction.

Assessment of principles

23. As noted above, the level of observance for each ICP reflects the assessments of its standards. An ICP will be considered **observed** whenever all the standards are considered to be observed or when all the standards are observed except for a number that are considered not applicable. An ICP will be considered to be **not applicable** when the standards are considered to be not applicable.

24. With respect to an assessment of an ICP that is other than observed or not applicable, similar guidance is to be used as applies to the standards themselves. So, for an ICP to be considered **largely observed,** it is necessary that only minor shortcomings exist which do not raise any concerns about the supervisor's ability to achieve full observance with the ICP. An ICP will be considered **partly observed** whenever, despite progress, the shortcomings are sufficient to raise doubts about the supervisor's ability to achieve observance. An ICP will be considered **not observed** whenever no substantive progress toward observance has been achieved.

25. While it is generally expected that full observance of an ICP would be achieved through the observance of the standards, there may be instances, where a jurisdiction can demonstrate that observance with an ICP has been achieved through different means. Conversely, due to specific conditions in a jurisdiction, meeting the standards may not be sufficient to achieve observance of the objective of an ICP. In these cases, additional measures are needed in order for observance of the particular ICP to be considered effective.

Reporting

26. The IAIS does not prescribe the precise format or content of reports that result from an assessment against the ICPs. It does, however, consider that the report should:

- be in writing
- include both the assessment of observance itself and any additional information referred to in this section
- identify the scope and timing of the assessment
- in the case of an external assessment, identify the assessors
- in the case of an external assessment, refer to the information reviewed and meetings conducted, and note when any of the necessary information was not provided and the impact that this may have had on the accuracy of the assessment
- in the case of an external assessment, include prioritised recommendations for achieving improved observance of the ICPs recognising that the assessment should not be considered as an end in itself
- in the case of an external assessment, include the formal comments provided by the supervisors in response to the assessment
- include a review of areas identified in this section as the preconditions to effective supervision.

27. The question of publication of the results of an assessment is a matter for the local authorities.

ICP 1 Objectives, Powers and Responsibilities of the Supervisor

The authority (or authorities) responsible for insurance supervision and the objectives of insurance supervision are clearly defined.

1.1 Primary legislation clearly defines the authority (or authorities) responsible for insurance supervision.

1.1.1 The authority (or authorities) responsible for insurance supervision should be clearly identified in primary legislation. Where there are multiple authorities responsible for insurance supervision (e.g. separate authorities for prudential and market conduct supervision, for macro and micro prudential supervision, or for licensing and ongoing supervision), it is important that the institutional framework and the responsibilities of the respective authorities are clearly set out in legislation for clarity and to ensure all the objectives of insurance supervision are met.

1.2 Primary legislation clearly defines the objectives of insurance supervision and the mandate and responsibilities of the supervisor and gives the supervisor adequate powers to conduct insurance supervision, including powers to issue and enforce rules by administrative means and take immediate action.

1.2.1 Publicly defined objectives foster transparency. With this basis, the public, government, legislatures and other interested bodies can form expectations about insurance supervision and assess how well the authority is achieving its mandate and fulfilling its responsibilities.

1.2.2 Being entrenched in primary legislation ensures that the mandate and functions of the supervisor cannot be changed on an ad-hoc basis. The process of periodically updating the primary legislation can promote transparency by way of public discussions on relevant issues; however, if done too frequently, stakeholders may form the impression that the policymaking process is unstable. Therefore, it would be prudent to avoid being overly specific in the primary legislation, which could be supplemented as needed with updated regulations, for example.

1.2.3 Legislation should be clearly specified and sufficiently extended so that the objectives of legal entity and group-wide supervision are allowed for and the supervisor has adequate powers to achieve these objectives.

1.2.4 The objectives of group-wide supervision could be achieved either by direct means where the supervisor has explicit authority and powers over entities within the group, including the head of the group, or via the use of an indirect approach where the supervisor has adequate power and authority over the regulated insurer to access information in respect of the head of and other entities in the group and apply relevant requirements.

1.2.5 As overall coordinator for the supervision of the group, the group-wide supervisor should have sufficient legal power and authorities in place in order to practice supervision on a group-wide basis whilst also effecting coordination and collaboration with other relevant supervisors.

1.2.6 The group-wide supervisor should have sufficient authority and power in order to coordinate and disseminate the essential information needed for reviewing and evaluating risks and assessing solvency on a group-wide basis. A group-wide supervisor ultimately should be responsible for ensuring effective and efficient group-wide supervision.

1.2.7 At a jurisdictional level, it is important that legislation supports the supervisor of an insurer which is part of a group to appropriately contribute to the supervision of that group on a group-wide basis.

1.3 The principal objectives of supervision promote the maintenance of a fair, safe and stable insurance sector for the benefit and protection of policyholders.

1.3.1 While the precise objectives of supervision may vary by jurisdiction, it is important that all insurance supervisors are charged with the objective of protecting the interests of policyholders.

1.3.2 Often the supervisor's mandate includes several objectives. As financial markets evolve and depending on current financial conditions, the emphasis a supervisor places on a particular objective may change and, where requested, this should be explained.

1.4 Where, in the fulfilment of its objectives, the supervisor identifies conflicts between legislation and supervisory objectives, the supervisor initiates or proposes correction in legislation.

1.4.1 As markets evolve, the supervisor may identify changes in the environment that affect the fairness, safety or stability of the insurance sector that are not currently addressed by legislation. The supervisor should initiate or propose changes to legislation to ensure supervisory objectives can continue to be achieved.

ICP 2 Supervisor

The supervisor, in the exercise of its functions and powers:

- **is operationally independent, accountable and transparent**
- **protects confidential information**
- **has appropriate legal protection**
- **has adequate resources**
- **meets high professional standards.**

2.1 The governance structure of the supervisor is clearly defined. Internal governance procedures, including internal audit arrangements, are in place to ensure the integrity of supervisory actions. There is effective communication and prompt escalation of significant issues to appropriate levels within the supervisor. The decision-making lines of the supervisor are structured in such a way that action can be taken immediately in the case of an emergency.

2.1.1 Independence should be accompanied by accountability to ensure that the supervisor performs its functions in accordance with the mandate it is given in legislation and does not act beyond its powers. Failure by the supervisor to meet or deviation from its objectives should be explained to relevant stakeholders. The supervisor is accountable for the actions it takes in fulfilling its mandate to those who delegated the responsibility - the government or the legislature - as well as to those it supervises and the public at large. It should provide the rationale for decisions taken.

2.2 There are explicit procedures regarding the appointment and dismissal of the head of the supervisor and members of its governing body, if such a governing body exists. When the head of the supervisor or members of its governing body are removed from office, the reasons are publicly disclosed.

2.2.1 The “head of the supervisor” refers to the individual who heads the management team (in some cases referred to as the “management board”) and exercises full management responsibility for the day-to-day functioning and decisions of the supervisor, while the “governing body” would be the body of individuals that exercises oversight of the management team. The “head of the supervisor” may or may not also be a member of the “governing body”.

2.3 The institutional relationships between the supervisor and the executive and judicial authorities are clearly defined and transparent. Circumstances where executive overrides are allowed are specified.

2.3.1 It is important to define the relationship between the supervisor and the executive and judicial authorities, including the circumstances and processes for sharing information, consultation or approval with the relevant authority and the manner in which the supervisor could be subject to judicial review. This might include establishing what information should be provided, how each entity should consult on matters of mutual interest and when approval from relevant authorities is necessary.

2.4 The supervisor and its staff are free from undue political, governmental and industry interference in the performance of supervisory responsibilities. The supervisor is financed in a manner that does not undermine its independence. The supervisor has discretion to allocate its resources in accordance with its mandate and objectives and the risks it perceives.

2.4.1 Operational independence of the supervisor includes having the discretion to allocate its financial and human resources in accordance with its objectives.

2.4.2 In the ordinary course of business, the supervisor should not manage or otherwise run the insurers it supervises. A member of the governing body of the supervisor should exclude him/herself from decisions where he/she is in a conflict of interest position.

2.5 There are clear and transparent regulatory requirements and supervisory procedures which are appropriate for the objectives they are intended to meet. The supervisor applies them consistently and equitably, taking into account the nature, scale and complexity of insurers. These regulatory requirements and supervisory procedures are published.

2.6 Regulatory requirements and supervisory procedures are reviewed regularly. All material changes are normally subject to prior public consultation**.**

2.6.1 Significant changes to the supervisor's regulatory requirements and supervisory procedures should be subject to appropriate consultation with the public and the insurance industry. This would include not only substantive rules of general applicability but also policies and interpretations that are not confidential but that may affect members of the public. Detailed procedural manuals that are normally internal documents used to guide staff of the supervisor in the performance of their day-to-day duties would be excluded.

2.7 The supervisor publishes information on the insurance sector, about its own role and how it performs its duties.

2.7.1 Unless reliably published by other parties in a timely fashion, the supervisor publishes information and analysis about the financial condition of the insurance sector.

2.7.2 Transparency reinforces accountability of supervisors. The supervisor publishes:

- information on its role and responsibilities;
- a report, at least annually and in a timely manner on the conduct of its supervision describing its performance in pursuing its objectives;
- information and analysis about the financial situation of the insurance sector;
- information about problem or failed insurers, including information on supervisory actions taken, subject to confidentiality considerations and in so far as it does not jeopardise other supervisory objectives; and
- its audited financial statements at least annually.

2.8 There are processes to appeal against supervisory decisions, including using judicial review. These processes are specific and balanced to preserve supervisory independence and effectiveness. However, they do not unduly impede the ability of the supervisor to make timely interventions in order to protect policyholders' interests.

2.8.1 The existence of an appeals or review mechanism helps ensure that regulatory and supervisory decisions are made within the law as consistently as possible and are well reasoned. However, this should not unduly impede the ability of the supervisor to exercise its functions and powers effectively and swiftly.

2.9 The supervisor, including its staff and any individual acting on its behalf (presently or in the past), are required by legislation to protect the confidentiality of information in the possession of the supervisor, including confidential information received from other supervisors. The supervisor maintains appropriate safeguards for the protection of confidential information. Wrongful disclosure of confidential information is subject to penalties. The supervisor denies any request for confidential information, other than when required by law, or when requested by another supervisor who has a legitimate supervisory interest and the ability to uphold the confidentiality of the requested information.

2.9.1 The penalties for the wrongful disclosure of confidential information should be specified in legislation. Such penalties may include disciplinary actions or criminal proceedings.

2.9.2 All persons (presently or in the past) gaining access to confidential information should be subject to the penalties for the wrongful disclosure of that information.

2.9.3 The supervisor takes all actions necessary to preserve, protect and maintain the confidentiality of information received from another supervisor.

2.9.4 Confidential information exchanged belongs to, and remains the property of, the supervisor providing the information.

2.9.5 Safeguards for the protection of information include the restriction of access by the supervisor to confidential information received from another supervisor to those persons working for the supervisor or acting on its behalf who:

- are subject to confidentiality requirements
- are under its direct supervision and control, and
- have a need for such information that is consistent with, and directly related to, the purposes for which the information was requested.

2.9.6 Supervisors should identify the data protection requirements attached to information it receives and retain such information only for as long as permitted by the data protection requirements.

2.10 The supervisor and its staff have the necessary legal protection against lawsuits for actions taken in good faith while discharging their duties, provided they have not acted illegally. They are adequately protected against the costs of defending their actions while discharging their duties.

2.10.1 Operational independence of the supervisor includes having legal protection for the actions the supervisor takes in the performance of its functions.

2.11 The supervisor has adequate resources, financial or otherwise, sufficient to enable it to conduct effective supervision. Its staffing policies enable it to attract and retain highly skilled, competent and experienced staff. The supervisor provides adequate training for its staff. The supervisor has the ability to hire or contract the services of outside experts when necessary.

2.11.1 As part of its annual resource planning exercise, the supervisor should take stock of existing skills, experience and projected requirements over the short to medium term and review and implement measures that could be taken to bridge any gaps in numbers and/or skill-sets. Such measures could include more flexible hiring policies, schemes for secondment of staff to industry, other supervisory authorities within the jurisdiction or internationally. This effort would be aimed at providing access to specialist skills on a temporary basis as well as provide opportunities for supervisory staff to better understand industry practices.

2.11.2 The supervisor should have the ability to undertake the role of a group-wide supervisor as deemed necessary.

2.12 The supervisor and its staff act with integrity and observe the highest professional standards, including observing conflict of interest rules.

2.12.1 Strong internal governance (as assessed in Standard 2.1) and maintenance of high standards of integrity and professional standards amongst the staff of the supervisor are important elements that contribute to the credibility of the supervisory process. This includes having a code of conduct which incorporates rules dealing with conflict of interest.

2.13 Where the supervisor outsources supervisory functions to third parties, the supervisor sets expectations, assesses their competence and experience, monitors their performance, and ensures their independence from the insurer or any other related party. Outside experts hired by the supervisor are subject to the same confidentiality rules and professional standards as the staff of the supervisor.

2.13.1 Outsourcing of some supervisory functions to third parties can complement the supervisor's resources with valuable expertise. However, the oversight and control of supervisory functions is the primary responsibility of the supervisor and the complete outsourcing of supervisory responsibility to third parties is not an acceptable substitute for that performed by supervisors.

ICP 3 Information Exchange and Confidentiality Requirements

The supervisor exchanges information with other relevant supervisors and authorities subject to confidentiality, purpose and use requirements.

3.1 The supervisor has the legal authority and power to obtain and exchange supervisory information in respect of legal entities and groups, including the relevant non-regulated entities of such groups.

3.1.1 The legal authority and power to which the supervisor is subject should enable it to obtain and exchange information when:

- the supervisor considers the information to be necessary for the supervision of insurance legal entities or groups, or when another supervisor considers the information to be necessary, and
- the supervisor is reasonably requested to provide relevant information by one of the authorities referred to in 3.2.1 below.

3.1.2 Information necessary for the supervision of insurance legal entities or groups may include, but is not limited to:

- information on the management and operational systems and controls operated by insurers;
- financial data relating to an insurer;
- objective information on individuals holding positions of responsibility in insurers (to include owners, shareholders, directors, managers, employees or contractors);
- objective information on individuals or insurers involved, or suspected of being involved, in criminal activities;
- information on regulatory investigations and reviews, and on any restrictions imposed on the business activities of insurers;
- specific information requested and gathered from a supervised entity (including appropriate customer transactional information);
- reporting information within groups to meet group supervisory requirements;
- information on a legal entity and a group-wide basis including, but not limited to, branches, subsidiaries and non-regulated holding companies; and
- information on prospective and actual insurer transactions and prospective and actual transactions of policyholders.

Agreements on the information exchange

3.1.3 Agreements and understandings can be used to establish a framework between supervisors to facilitate the efficient execution of requests for or provision of information.

3.1.4 Agreements such as the IAIS Multilateral Memorandum of Understanding (MMoU) or bilateral Memoranda of Understanding (MoU) facilitate information exchange because they provide the basis for a two way flow of information and the basis on which supervisors can rely on the information they exchange with other supervisors being treated as confidential.

3.1.5 The IAIS MMoU is an example of a multilateral memorandum of understanding for cooperation and exchange of information between insurance supervisors in relation to all issues related to the supervision of insurers – also covering insurance groups. All signatories to the IAIS MMoU have to undergo a validation of their laws and regulations to guarantee compliance with the strict confidentiality regime set forth therein.

3.1.6 Agreements and understandings are valuable where there is a need to provide a basis for exchanging information between the supervisors in two or more jurisdictions, or between supervisors responsible for different financial sectors.

3.1.7 An agreement or understanding may set out the types of information to be exchanged, as well as the basis on which information obtained by the supervisor may be shared.

Supervisory colleges

3.1.8 Information exchange is particularly important for the operation of a supervisory college. For a supervisory college to be effective there needs to be mutual trust and confidence between supervisors, particularly in relation to exchange and protection of confidential information.

3.1.9 It is the responsibility of each supervisor within the supervisory college to ensure the safe handling of confidential information; there is no global law or regulation on confidential information. Each member of the supervisory college should take measures necessary to avoid unintentional divulgence of information or the unauthorised release of confidential information. It is vital that appropriate information exchange agreements or direct arrangements are in place between the members of the supervisory college to ensure that information can be exchanged in a secure environment.

3.1.10 There are two principal methods by which this could be achieved:

- Each supervisor involved in the supervisory college establishes a MoU on a bilateral basis with the other members of a supervisory college. In many instances such MoUs already exist.
- The members of the supervisory college are signatories to the IAIS MMoU which requires the commitment to a strict confidentiality regime.

3.1.11 Where confidential information exchanged within a supervisory college is also communicated to other supervisors there should be a formal mechanism in place with these supervisors to ensure the protection of the confidential information. Mechanisms could be included in MoUs or via direct arrangement.

3.2 The supervisor has the legal authority and power, at its sole discretion and subject to appropriate safeguards, to exchange information with other relevant supervisors. The existence of an agreement or understanding on information exchange is not a prerequisite for information exchange.

3.2.1 Other relevant supervisors may include, but are not limited to,:

- other insurance supervisors within the jurisdiction;
- insurance supervisors in other jurisdictions;
- supervisors responsible for banks and other credit institutions both within the jurisdiction and in other jurisdictions;
- supervisors responsible for investments, securities, financial markets and other sectors both within the jurisdiction and in other jurisdictions;
- relevant authorities for anti-money laundering or combating the financing of terrorism (AML/CFT matters); and/or
- law enforcement agencies.

3.3 The supervisor proactively exchanges material and relevant information with other supervisors. The supervisor informs any other supervisor in its jurisdiction and the supervisors of insurance group entities in other jurisdictions or sectors in advance of taking any action that might reasonably be considered to affect those group entities. Where prior notification is not possible, the supervisor informs other relevant supervisors as soon as possible after taking action.

3.3.1 Relevant proactively provided information includes but is not limited to:

- any information the supervisor considers will facilitate the effective supervision of groups or entities in the group
- any material changes in the supervisory approach
- any event or series of events that may have a significant bearing on the operations of group entities operating in the jurisdictions of other supervisors
- information that may affect the financial system of another jurisdiction
- information that may affect the financial condition or other interests of the policyholders of a group entity in another jurisdiction
- prior notification to another supervisor of any action to be undertaken which relies on information received from that supervisor, subject to the compulsory requirements applicable to the supervisor of criminal justice or other legislation.

3.4 The supervisor has a legitimate interest and a valid purpose related to the fulfilment of supervisory functions in seeking information from another supervisor.

3.4.1 Valid purposes may include, but are not limited to:

- licensing
- fit and proper criteria
- ongoing supervision, including enforcement action and sanctions
- supervisory practices
- winding-up, liquidation or bankruptcy
- anti-money laundering or combating the financing of terrorism (AML/CFT).

3.5 The supervisor assesses each request for information from another supervisor on a case by case basis.

3.5.1 By way of principle, a supervisor is expected to provide the information requested by another supervisor. In deciding whether and to what extent to fulfil a request for information, the supervisor may take into account matters such as, but not limited to:

- whether it would be contrary to the essential interest of the jurisdiction of the requested supervisor
- the ability of the recipient supervisor to maintain the confidentiality of any information exchanged, taking account of the legal arrangements in each jurisdiction
- relevant legislation in their jurisdiction (in particular those relating to confidentiality and professional secrecy, data protection and privacy, and procedural fairness)
- the nature of the information to be exchanged
- the use to which the information will be put (for example, see Standard 3.4).

3.5.2 Whilst requests for information should normally be made in writing, the supervisor should not insist on written requests in an emergency situation, and should not unreasonably delay a response to an oral request, where the requesting supervisor is known to it.

3.6 The supervisor responds in a timely and comprehensive manner when exchanging relevant information and in responding to requests from supervisors seeking information.

3.6.1 Supervisors should consider nominating an individual to act as their main contact point to facilitate the free flow of information.

3.7 Strict reciprocity in terms of the level, format and detailed characteristics of information exchanged is not required by the supervisor.

3.7.1 Lack of strict reciprocity should not be used by the supervisor as the reason for not exchanging information that it would otherwise be

appropriate to exchange – particularly in an emergency or other crisis situation.

3.8 Before exchanging confidential information, the supervisor ensures that the party receiving the information is bound by confidentiality requirements.

3.9 The supervisor generally permits the information it exchanged with another supervisor to be passed on to other relevant supervisors or other bodies in that jurisdiction, provided that the necessary confidentiality requirements are in place.

3.9.1 Other parties with whom supervisors may wish to exchange information may include the authorities listed at Standard 3.2 above or other authorities such as those with jurisdiction over a supervisor or relevant courts.

3.9.2 The originating supervisor may attach conditions to the subsequent exchange of the information to other supervisors or other bodies.

3.9.3 Conditions imposed by the originating supervisor on the exchange of information should not prevent the receiving supervisor from being able to use the information for its own purposes in accordance with Standard 3.10.

3.10 The supervisor receiving confidential information from another supervisor uses it only for the purposes specified when the information was requested. Before using the information for another purpose, including exchanging it with other parties, the supervisor obtains agreement of the originating supervisor.

3.10.1 There are specified circumstances within Annex B of the IAIS MMoU whereby signatories are considered to have provided consent to the passing on of information where it will assist other IAIS MMoU signatories in the performance of their supervisory functions and other relevant domestic bodies (including central banks, law enforcement agencies and relevant courts).

3.11 In the event that the supervisor is legally compelled to disclose confidential information it received from another supervisor, the supervisor promptly notifies the originating supervisor, indicating what information it is compelled to release and the circumstances surrounding the release. Where consent to passing this information on is not given, the supervisor uses all reasonable means to resist the demand and to protect the confidentiality of the information.

3.11.1 Legal compulsion includes but is not limited to a court or parliamentary order.

ICP 4 Licensing[4]

A legal entity which intends to engage in insurance activities must be licensed before it can operate within a jurisdiction. The requirements and procedures for licensing must be clear, objective and public, and be consistently applied.

Introductory Guidance

4.0.1 Licensing contributes to efficiency and stability in the insurance sector. Strict conditions governing the formal approval through licensing of insurance legal entities are necessary to protect consumers. The relevant licensing criteria should be applied to prospective entrants consistently to promote a level playing field at point of admission to the insurance sector. Licensing requirements and procedures should not be used inappropriately to prevent or unduly delay access to the market.

4.0.2 The role of the supervisor in licensing is to assess whether insurance legal entities are able to fulfil their obligations to policyholders on an ongoing basis. The licensing procedure is the first step towards achieving this objective.

4.0.3 Licensing is distinct from approval granted in terms of general domestic company, trade or commercial law. Apart from applying for a supervisory licence, other requirements pertaining to company, trade or commercial law should be met (e.g. filing incorporation documents or applying to the registrar of commerce).

Licensing requirements

4.1 The insurance legislation:

- **includes a definition of insurance activities which are subject to licensing;**
- **prohibits unauthorised insurance activities;**
- **defines the permissible legal forms of domestic insurance legal entities;**
- **allocates the responsibility for issuing licences; and**
- **sets out the procedure and form of establishment by which foreign insurers are allowed to conduct insurance activities within the jurisdiction.**

4.1.1 Jurisdictions may decide to exclude some activities from the definition of insurance activities subject to licensing. Any such activities should be explicitly stated in the legislation. Jurisdictions may do this for various reasons, such as:

- the insured sums do not exceed certain amounts;
- losses are compensated by payments in kind;

[4] Amended November 2015

- activities are pursued following the idea of solidarity between policyholders (e.g., small mutuals, cooperatives and other community-based organisations, especially in the case of microinsurance); or
- the entities' activities are limited to a certain geographical area, limited to a certain number or class of policyholders and/or offer special types of cover such as products not offered by licensed domestic insurance legal entities.

4.1.2 Given the principle that all entities engaged in insurance activities must be licensed, the exclusion of limited insurance activities from licensing requirements should give due regard to having appropriate alternative safeguards in place to protect policyholders.

4.1.3 Similarly, jurisdictions may allow a simplified process for non-significant entities (e.g. limited geographic scope, limited size, and limited lines of business) for the purposes of licensing. In such situations, the legislation should state clearly the applicability, requirements and process for such authorisation.

4.1.4 In jurisdictions where an authority other than the insurance supervisor is responsible for issuing licences, the insurance supervisor should be able to give input and recommend conditions or restrictions (including refusal) on a licence where appropriate to the licensing authority.

4.2 A jurisdiction controls through licensing which entities are allowed to conduct insurance activities within its jurisdiction.

4.2.1 Entities should neither be allowed to present themselves nor act as licensed insurance legal entities without or before having been granted a licence.

4.2.2 Depending on the legal forms that are permitted in a jurisdiction, foreign insurers may be allowed to conduct insurance activities within the jurisdiction by way of a local branch or subsidiary or on a cross-border provision of services basis. A subsidiary is a domestically established legal entity that needs to be licensed. A branch is not separate from the insurance legal entity, and can be established in a jurisdiction other than the insurance legal entity's home jurisdiction. A host jurisdiction may require that branches of foreign insurance legal entities be licenced or otherwise authorised by the host supervisor. Cross-border provision of services does not require a local establishment but may require authorisation from the host supervisor.

4.2.3 In some regions, a number of jurisdictions have agreed to a system of passporting as a manner of acknowledging each other's licences. This provides the opportunity for insurance legal entities established in one of the jurisdictions to open branches or provide insurance services across borders on the basis of their home jurisdiction authorisation to conduct insurance activities. Where a foreign insurer may be allowed to operate through a branch or cross-border provision of services without a licence or other authorisation from the host supervisor, it is important that bilateral or multilateral agreements are in place which ensure that the insurer:

- is subject to supervision in its home jurisdiction which has been recognised as adequate by the host jurisdiction; and

- may be subject to sanction or other supervisory measures if it does not meet the legal provisions of the host jurisdiction. In such circumstances, the home supervisor should be informed.

4.3 Licensing requirements and procedures are clear, objective and public, and are consistently applied. At a minimum, the applicant is required to:

- **have sound business and financial plans;**
- **have a corporate or group structure that does not hinder effective supervision;**
- **establish that the applicant's Board Members, both individually and collectively, Senior Management, Key Persons in Control Functions and Significant Owners are suitable;**
- **have an appropriate governance framework; and**
- **satisfy capital requirements.**

4.3.1 In addition to being publicly available, licensing requirements should also be easily accessible. Supervisors should issue guidelines on how to file an application for a licence, which include advice on the required format of documents and the expected time it would take to process an application upon the receipt of all relevant documents.

4.3.2 Supervisors should assess the applicant's business and financial plans to ascertain that the proposed business lines will be soundly managed and adequately capitalised. Business and financial plans should be projected for a minimum of three years by the applicant and include information such as the products to be offered, distribution methods and channels to be used, risk profile, projected setting-up and development costs by business line, capital requirements and solvency margins. Information regarding primary insurance and reinsurance should also be provided.

4.3.3 Where the applicant is part of a group, the applicant should submit its corporate and group structure, indicating all of the material entities within the group (including both insurance legal entities and other entities, including non-regulated entities). Information on the type of related party transactions and/or relationships between all material entities within the group should also be provided.

4.3.4 The applicant should also provide information to demonstrate the appropriateness of its systems of risk management and internal controls, including contracts with affiliates, outsourcing arrangements, information technology systems, policies and procedures.

4.3.5 If applying to be licensed to underwrite both life insurance business and non-life insurance business (where such is allowed), the applicant should demonstrate to the satisfaction of the supervisor that its systems of risk management and internal controls are adequate to manage the risks separately for each business stream on both a going concern and a gone concern basis.

4.3.6 Further guidance on suitability, governance and capital requirements can be found in ICP 5 (Suitability of Persons), ICP 7 (Corporate Governance),

ICP 8 (Risk Management and Internal Controls) and ICP 17 (Capital Adequacy).

Requirements on the supervisor

4.4 The supervisor assesses applications, makes decisions and informs applicants of the decision within a reasonable time, which is clearly specified, and without undue delay.

4.4.1 The supervisor should require an entity to submit an application if it proposes to conduct insurance activities. The application should include information on the types of business to be written and contain all the documents and information required by the legislation to confirm that the licensing requirements are met.

4.4.2 In instances where the application is deemed not complete, the supervisor should inform the applicant without delay, and the applicant should be given the opportunity to provide additional information to complete the application.

4.4.3 In assessing the application, the supervisor could rely on audits by external bodies, actuarial reports, or in the case of branches or foreign subsidiaries on the opinion of other supervisors. Supervisors should consider the reports or opinions from these various sources carefully and apply their own judgment in making the final decision on the application. Before placing reliance on reports from external auditors or actuaries, supervisors should consider:

- whether the external auditors and actuaries have the necessary expertise and experience to perform the roles; and
- their independence from the entity and the consideration they give to the protection of policyholders' interests.

4.4.4 The supervisor should make its assessment and finalise its decision within a reasonable timeframe and without undue delay. A time period should be indicated to the applicant for the assessment procedure, commencing from the date on which all complete application documentation has been submitted to the supervisor. Within this period, the supervisor should decide on the acceptability of the application for a licence. However, this does not preclude the supervisor from conducting additional due diligence if necessary. If the supervisor has not come to a decision within the indicated timeframe and the licence cannot be granted, the supervisor should communicate the reason for the delay to the applicant.

4.5 The supervisor refuses to issue a licence where the applicant does not meet the licensing requirements. Where the supervisor issues a licence, it imposes additional requirements, conditions or restrictions on an applicant where appropriate. If the licence is denied, conditional or restricted, the applicant is provided with an explanation.

4.5.1 In general, requirements, conditions or restrictions that are imposed on an applicant at the point of issue of the licence deal with the scope of activities that an insurance legal entity is permitted to conduct or the nature of its customers (e.g. retail versus sophisticated customers). If

necessary, the supervisor should impose additional requirements, conditions or restrictions on an applicant not only at the point of issue of the licence, but also as part of its on-going supervision of the insurance legal entity. Further standards and guidance on supervisory review and reporting and on preventive and corrective action can be found in ICP 9 (Supervisory Review and Reporting) and ICP 10 (Preventive and Corrective Measures).

4.5.2 The denial of a licence or conditions or restrictions on a licence should be confirmed in writing to the applicant. The explanation should be provided to the applicant in a transparent manner. Supervisors should convey their concerns with regard to an applicant's proposed insurance activities and explain the reasons for imposing licensing conditions or restrictions.

4.6 A licence clearly states its scope.

4.6.1 A licence should clearly state the classification of insurance activities that the insurance legal entity is licensed to conduct. Regarding classification, legislation should categorise insurance business into types and classes of insurance (at least into life and non-life).

4.6.2 Before adding new classes of insurance to the list of classes already granted to the insurance legal entity, the supervisor should consider all of the above mentioned licensing requirements, as applicable.

4.7 The supervisor publishes a complete list of licensed insurance legal entities and the scope of the licences granted.

4.7.1 The supervisor should publish the complete list of licensed insurance legal entities and clearly state the scope of licence that has been granted to each insurance legal entity. This would provide clarity to the public as to which entities are licensed for specific classes of business.

4.7.2 If the conditions or restrictions to the license would impact the public or any person dealing with the insurance legal entity, the supervisor should either publish these conditions or restrictions or require the insurance legal entity to disclose these conditions or restrictions accordingly. Conditions or restrictions that would impact the public could include, for example, the lines or classes of insurance business an insurance legal entity is permitted to conduct.

Foreign operations

4.8 In deciding whether and if so on what basis, to license or continue to license a branch or subsidiary of a foreign insurer in its jurisdiction, the supervisor consults the relevant supervisor(s) as necessary.

4.8.1 As part of the consultation, supervisors should use the modes available for supervisory cooperation, in particular, the ability to exchange information relevant for the application (e.g. check of suitability of directors and owners) with domestic or foreign authorities. The exchange of information may be governed by law, agreement or memorandum of understanding, especially if the information is deemed confidential. Having such arrangements in place is important so as to not unduly delay the processing of an application.

4.8.2 Before making a decision to grant the licence, the host supervisor should have an understanding of how the home supervisor and/or the group-wide supervisor supervise the insurer on an ongoing basis.

4.8.3 Host supervisors should consult home supervisors on relevant aspects of any licensing proposal, but in any event they should always consider checking that the home supervisor of the insurance legal entity has no objection before granting a licence. The home supervisor and/or the group wide supervisor should assess the risks posed to the insurer of establishing an insurance legal entity in a foreign jurisdiction and highlight any material reservations or concerns to the host supervisor as soon as practicable. The host supervisor should inform the home supervisor of the scope of the licence, including any restrictions or prohibitions imposed on the licence.

4.8.4 Host supervisors should reject applications for a licence from foreign entities which are not subject to regulation and supervision in the home jurisdiction. In the case of joint ventures, if there is lack of clear parental responsibility, the supervisor should reject such applications.

4.9 Where an insurance legal entity is seeking to conduct cross-border insurance activities without a physical presence in the jurisdiction of the host supervisor, the host supervisor concerned consults the home supervisor, as necessary, before allowing such activities.

4.9.1 Jurisdictions or regions may have a system or cooperation agreements in place whereby such consultation is not necessary or required.

4.9.2 Information exchanged as part of a consultation should include:

- confirmation from the home supervisor that the insurance legal entity is authorised to conduct the proposed types of insurance activities; and
- confirmation from the home supervisor that the insurance legal entity meets all the insurance regulatory requirements in the home jurisdiction.

ICP 5 Suitability of Persons[5]

The supervisor requires Board Members, Senior Management, Key Persons in Control Functions and Significant Owners of an insurer to be and remain suitable to fulfil their respective roles.

5.1 Legislation identifies which persons are required to meet suitability requirements. At a minimum, the legislation includes Board Members, Senior Management, Key Persons in Control Functions and Significant Owners.

5.1.1 Suitability requirements may extend to other individuals (e.g. financial controllers and treasurers) to account for the roles of such individuals that may differ depending on the jurisdiction and the legal form and governance structure of the insurer.

5.2 The supervisor requires that in order to be suitable to fulfil their roles:

- **Board Members (individually and collectively), Senior Management and Key Persons in Control Functions possess competence and integrity; and**
- **Significant Owners possess the necessary financial soundness and integrity.**

Suitability requirements for Board Members, Senior Management and Key Persons in Control Functions

5.2.1 Competence is demonstrated generally through the level of an individual's professional or formal qualifications and knowledge, skills and pertinent experience within the insurance and financial industries or other businesses. Competence also includes having the appropriate level of commitment to perform the role. Refer to ICP 7 (Corporate Governance) with regard to competence and commitment and to ICP 8 (Risk Management and Internal Controls) with regard to control functions.

5.2.2 Integrity is demonstrated generally through character, personal behaviour and business conduct.

5.2.3 The supervisor should require the insurer to take the necessary measures to ensure that these requirements are met by setting high internal standards of ethics and integrity, promoting sound corporate governance and requiring that these individuals have pertinent experience, and maintain a sufficient degree of knowledge and decision making ability.

5.2.4 To ensure an appropriate level of suitability, Board Members, Senior Management and Key Persons in Control Functions should acquire, maintain and enhance their knowledge and skills to fulfil their roles, for example, by participating in induction and ongoing training on relevant issues. Sufficient time, budget and other resources should be dedicated for this purpose, including external expertise drawn upon as needed.

[5] Amended November 2015

More extensive efforts should be made to train those with more limited financial, regulatory or risk-related experience.

Suitability requirements for Significant Owners

5.2.5 At a minimum, the necessary qualities of a Significant Owner relate to:

- financial soundness demonstrated by sources of financing/funding and future access to capital; and
- integrity demonstrated in personal or corporate behaviour.

5.3 The supervisor requires the insurer to demonstrate initially and on an ongoing basis, the suitability of Board Members, Senior Management, Key Persons in Control Functions and Significant Owners. The suitability requirements and the extent of review required by the supervisor depend on the person's role.

5.3.1 The supervisor should assess the suitability of Board Members, Senior Management, Key Persons in Control Functions and Significant Owners of an insurance legal entity as part of the licensing procedure before the insurance legal entity is permitted to operate. See ICP 4 (Licensing).

5.3.2 The supervisor should assess the suitability of Board Members, Senior Management, Key Persons in Control Functions and Significant Owners of insurers either prior to changes in the positions or as soon as possible after appointment. The supervisor should also require the insurer to perform internal suitability assessments of Board Members, Senior Management and Key Persons in Control Functions on an ongoing basis, for example on an annual basis or when there are changes in the circumstances of the individuals. The supervisor may require the insurer to certify that it has conducted such assessments and demonstrate how it reached its conclusions.

5.3.3 With regard to Control Functions, the individual(s) to be assessed should be the Key Persons in Control Functions.

5.3.4 The supervisor should have sufficient and appropriate information to assess whether an individual meets suitability requirements. The information to be collected and the supervisor's assessment of such information may differ depending on the role.

5.3.5 For the purpose of the assessment, the supervisor should require the submission of a résumé or similar indicating the professional qualifications as well as previous and current positions and experience of the individual and any information necessary to assist in the assessment, such as:

- evidence that the individual has sufficient relevant knowledge and pertinent experience within the insurance and financial industries or other businesses; and
- evidence that the individual has the appropriate level of commitment to perform the role.

5.3.6 The application of suitability requirements relating to competence for Board Members, Senior Management and Key Persons in Control Functions of an insurer may vary depending on the degree of their influence and on their roles. It is recognised that an individual considered

competent for a particular position within an insurer may not be considered competent for another position with different responsibilities or for a similar position within another insurer. When assessing the competence of the Board Members, regard should be given to respective duties allocated to individual members to ensure appropriate diversity of qualities and to the effective functioning of the Board as a whole.

5.3.7 In assessing the integrity of an individual Board Member, Senior Management, Key Person in Control Functions and Significant Owner, the supervisor should consider a variety of indicators such as:

- Legal indicators: These provide information on possible legal misconduct. Such indicators could include civil liability, criminal convictions or pending proceedings:
  - for breaches of law designed to protect members of the public from financial loss, e.g. dishonesty, or misappropriation of assets, embezzlement and other fraud or other criminal offences (including anti-money laundering and the combating of the financing of terrorism.
  - against the individual in his/her personal capacity;
  - against an entity in which the individual is or was a Board Member, a member of the Senior Management, a Key Person in Control Functions or a Significant Owner; or
  - incurred by the individual as a consequence of unpaid debts.
- Financial indicators: These provide information on possible financial misconduct, improper conduct in financial accounting, or negligence in decision-making. Such indicators could include:
  - financial problems or bankruptcy in his/her private capacity; or
  - financial problems, bankruptcy or insolvency proceedings of an entity in which the individual is or was a Board Member, a member of the Senior Management or a Key Person in Control Functions.
- Supervisory indicators: These provide information gathered by or that comes to the attention of supervisors in the performance of their supervisory duties. These supervisors could also be authorities with supervisory responsibility in sectors other than insurance. Such indicators could include:
  - the withholding of information from public authorities or submission of incorrect financial or other statements;
  - conduct of business transgressions;
  - prior refusal of regulatory approval for key positions;
  - preventive or corrective measures imposed (or pending) on entities in which the individual is or was a Board Member, a member of the Senior Management, or a Key Person in Control Functions; or

- outcome of previous assessments of suitability of an individual, or sanctions or disciplinary actions taken (or pending) against that individual by another supervisor.

- Other indicators: These may provide other information that could reasonably be considered material for the assessment of the suitability of an individual. Examples include:
  - suspension, dismissal or disqualification of the individual from a position as a Board Member or a member of the Senior Management of any company or organisation;
  - disputes with previous employers concerning incorrect fulfilment of responsibilities or non-compliance with internal policies, including code of conduct, employment law or contract law;
  - disciplinary action or measures taken against an individual by a professional organisation in which the individual is or was a member (e.g., actuaries, accountants or lawyers); or
  - strength of character, such as the ability and willingness to challenge, as an indicator of a person's integrity as well as competence to perform the respective role.

The presence of any one indicator may, but need not in and of itself, determine a person's suitability. All relevant indicators, such as the pattern of behaviour, should be considered in a suitability assessment. Consideration should also be taken to the lapse of time since a particular indicator occurred and its severity, as well as the person's subsequent conduct.

5.3.8 For Significant Owners, the supervisor sets out minimum standards of financial soundness. If the Significant Owner that is to be assessed is a legal person or a corporate entity, the supervisor should collect sufficient and appropriate information such as:

- the nature and scope of its business;
- its ownership structure, where relevant;
- its source of finance/funding and future access to capital;
- the group structure, if applicable, and organisation chart; and
- other relevant factors.

5.3.9 In determining the financial soundness of Significant Owners, the supervisor should assess their source of financing/funding and future access to capital. To do so, the supervisor may consider financial indicators such as:

- Financial statements and exhibits. If the Significant Owner is a legal person, financial statements may include annual financial statements; for a natural person, it may include financial information (such as tax accounts or personal wealth statements) that are reviewed by an independent public accountant; and

- Transactions and agreements such as: loans; investments; purchase, sale or exchange of securities or other assets; dividends and other distributions to shareholders; management agreements and service contracts; and tax allocation agreements.

5.3.10 Additionally the supervisor should also consider matters such as, but not limited to, whether:

- Significant Owners understand their role as potential future sources of capital, if needed;
- there are any indicators that Significant Owners will not be able to meet their debts as they fall due;
- appropriate prudential solvency requirements are met if the Significant Owner is a financial institution;
- Significant Owners have been subject to any legally valid judgment, debt or order that remains outstanding or has not been satisfied within a reasonable period;
- Significant Owners have made arrangements with creditors, filed for bankruptcy or been adjudged bankrupt or had assets sequestered; and
- Significant Owners have been able to provide the supervisor with a satisfactory credit reference.

The presence of any one indicator may, but need not in and of itself, determine a person's suitability. All relevant indicators, such as the pattern of behaviour, should be considered in a suitability assessment. If the Significant Owner is regulated by another supervisor, the suitability assessment done by the latter may be relied upon to the extent that this assessment reasonably meets the requirements of this standard.

5.4 The supervisor requires notification by insurers of any changes in Board Members, Senior Management, Key persons in Control Functions and Significant Owners, and of any circumstances that may materially adversely affect the suitability of its Board Members, Senior Management, Key Persons in Control Functions and Significant Owners.

5.4.1 Insurers should be required to report promptly any information gained about these persons that may materially affect their suitability, for example, if a Board Member is convicted of a financial crime. See guidance under Standard 5.3 for additional examples of indicators of circumstances that may materially affect the suitability of an individual.

5.5 The supervisor takes appropriate action to rectify the situation when Board Members, Senior Management and Key Persons in Control Functions or Significant Owners no longer meet suitability requirements.

5.5.1 The supervisor should impose measures in respect of Board Members, Senior Management and Key Persons in Control Functions who do not meet the suitability requirements. Examples of such measures include:

- requesting the insurer to provide additional education, coaching or the use of external resources in order to achieve compliance

with suitability requirements by an individual in a position as Board Member, member of the Senior Management or Key Person in Control Functions;

- preventing, delaying or revoking appointment of an individual in a position as Board Member, member of the Senior Management or Key Person in Control Functions;
- suspending, dismissing or disqualifying an individual in a position as a Board Member, Senior Management or Key Person in Control Function, either directly or by ordering the insurer to take these measures;
- requiring the insurer to appoint a different person for the position in question who does meet the suitability requirements, to reinforce the sound and proper management and control of the insurer;
- imposing additional reporting requirements and increasing solvency monitoring activities; or
- withdrawing or imposing conditions on the business licence, especially in the case of a major breach of suitability requirements, taking into account the impact of the breach or the number of members of the Board, Senior Management or Key Persons in Control Functions involved.

5.5.2 The supervisor should impose measures of a preventive and corrective nature in respect of Significant Owners who do not meet suitability requirements. Examples of such measures include:

- requiring the Significant Owners to dispose of their interests in the insurer within a prescribed period of time;
- the suspension of the exercise of their corresponding voting rights; or
- the nullification or annulment of any votes cast by the Significant Owners.

5.5.3 There can be circumstances where a Board Member, a member of the Senior Management or a Key Person in Control Functions is unable to carry out his/her role and a replacement needs to be appointed on short notice. In jurisdictions where the supervisor approves the post-licensing appointment of Board Members, Senior Management or Key Persons in Control Functions, it may be appropriate for the supervisor to permit the post to be filled temporarily until the successor's suitability assessment is affirmed. In such circumstances, a supervisor may require that these temporary replacements meet certain suitability requirements, depending on his/her position or responsibilities within the insurer. However, such assessment should be conducted and concluded in a timely manner.

5.6 The supervisor exchanges information with other authorities inside and outside its jurisdiction where necessary to check the suitability of Board Members, Senior Management, Key Persons in Control Functions and Significant Owners of an insurer.

5.6.1 Supervisors should use the modes available for supervisory cooperation, in particular, the ability to exchange information relevant to check suitability with domestic or foreign authorities. Having such arrangements in place is important so as to not unduly delay relevant supervisory processes and/or affect the insurers' ability to satisfy composition requirements for the Board or make necessary changes to its management team. For additional information, see ICP 3 (Information Exchange and Confidentiality Requirements).

5.6.2 The supervisor may use this information as an additional tool to assess effectively the suitability of, or to obtain information about, a Board Member, a member of the Senior Management or a Key Person in Control Functions.

5.6.3 If a Significant Owner that is to be assessed is a legal person or a corporate entity regulated in another jurisdiction, the supervisor should seek confirmation from the relevant authority that the entity is in good standing in that other jurisdiction.

ICP 6 Change of Control and Portfolio Transfers[6]

The supervisor assesses and decides on proposals:

- **to acquire significant ownership of, or an interest in, an insurer that results in a person (legal or natural), directly or indirectly, alone or with an associate, exercising control over the insurer; and**
- **for portfolio transfers.**

Introductory Guidance

6.0.1 The supervision of change of control and portfolio transfers supports supervisory objectives, in particular:

- licensing regimes are not undermined by control being obtained or retained by those who would not get a licence ordinarily; and
- insurers should continue to be held in corporate or other arrangements that allow them to be effectively supervised.

6.0.2 To assist in understanding the content of this ICP, it is emphasised that:

- change of control extends beyond the immediate controlling interest, such as the ownership of equity in an insurer, and includes other actions that have the potential to change the exercise of control over the insurer;
- change of control is relevant, both at the insurance legal entity and intermediate and ultimate beneficial owner levels;
- change of control may take place in a variety of forms, such as mergers, acquisitions or (de)mutualisations;
- control includes the exercise of influence over decisions including, but not limited to, decisions on strategic, operating, investing and financing policies of an insurer. It may also include the power to appoint or remove members, or otherwise influence the composition of, the Board or of Board committees;
- control may be exercised by a person individually, or acting in concert with associates or others, and directly or indirectly through corporate structures or other mechanisms; and
- significant owners and the transactions that determine or change control may be outside of a jurisdiction, but the impact on the ultimate control of the insurer in that jurisdiction means that they remain relevant to effective supervision of control.

6.0.3 Supervisory requirements and practices regarding change of control and portfolio transfers may vary, taking into account the nature, scale and complexity of the transactions and the risk posed to achievement of supervisory objectives. For example, portfolio transfers between reinsurers, internal restructuring transactions within a group that does not change the ultimate beneficial ownership of the entity, and

[6] Amended November 2018

demutualisation, are different types of transactions. Their nature may warrant different supervisory approaches and/or different levels of intensity of supervision.

6.0.4 There may be transactions where a portfolio transfer or a change of control is cross-border in nature. In such cases, the supervisor should coordinate and exchange information with the relevant supervisors (see ICP 3 Information Exchange and Confidentiality Requirements and ICP 25 Supervisory Cooperation and Coordination).

Change of Control

6.1 Legislation addresses change of control of insurers, including:

- **having a definition of control; and**
- **oversight and enforcement of requirements related to change of control.**

6.1.1 The definition of "control" should address, at least:

- holding of a defined number or percentage of issued shares or financial instruments above a designated threshold in an insurer or its intermediate or ultimate beneficial owner or the head of the insurance group or head of the financial conglomerate as may be the case; and/or
- having a defined percentage of voting rights attached to shares or financial instruments.

6.1.2 Financial instruments other than shares that should be of interest to the supervisor are those that have the potential to impact the levels of control over an insurer, including those that may convert in the future into an interest that leads to a change of control through that conversion.

6.1.3 The definition of a threshold for control is not necessarily the same as the definition that may apply for accounting consolidation or other purposes.

6.2 The supervisor requires the insurer to provide notification of a proposed change of control of the insurer. The supervisor assesses and decides on proposals for change of control.

Notification

6.2.1 The supervisor should require notification of proposals that would lead to increased (or decreased) control.

6.2.2 The supervisor should establish thresholds for notification. Such thresholds may improve transparency and compliance with related requirements while avoiding immaterial notifications. The supervisor typically establishes lower thresholds (such as between 5 and 10 percent) for initial notification of acquiring control, and a higher percentage for approval and for increased control also requiring approval.

6.2.3 The supervisor may also be informed by notifications made to other authorities such as corporate law supervisors or under rules for publicly traded companies.

6.2.4 Notifications should be submitted to the supervisor in a reasonable time. Changes that arise because of actions of the insurer should be subject to

advance notification. Actions of others are usually made "subject to" relevant approvals so are not effective until approved.

Assessment

6.2.5 The supervisor should assess both actions that lead to new controlling interests and those that lead to material increases in existing controlling interests. Material increases may arise, for example, when existing significant owners increase their interest, when associates increase their interest, or when a significant owner acquires a new associate who has a plan to acquire an interest (directly or indirectly) in the insurer.

6.2.6 The supervisor should obtain the information necessary to assess the change of control. The supervisor may seek such information from the insurer, its significant owners, shareholders or other relevant persons. The information obtained should be proportionate to the complexity of the change of control. Regardless, the supervisor should have sufficient information to understand the impact of the change of control on the insurer and be able to identify the ultimate beneficial owner.

6.2.7 When considering whether to approve a change of control that leads to a new significant owner, the supervisor should verify that the approval would not lead to a control arrangement that would not have been approved as part of the jurisdiction's licensing requirements in similar circumstances (see ICP 4 Licensing).

6.2.8 The supervisor should assess whether a new significant owner is suitable to fulfil its role. At a minimum, a significant owner should possess the necessary qualities relating to financial soundness and integrity (see ICP 5 Suitability of Persons).

6.2.9 The supervisor should be able to deny a change of control when, for example, it would be prejudicial to the interests of policyholders, the resulting structure would not allow for effective supervision, or the ultimate beneficial owner cannot be identified.

(De)Mutualisation

6.3 A change of a mutual company to a stock company, or vice versa, is subject to the supervisor's approval.

6.3.1 In jurisdictions where mutual ownership of insurers is possible, legislation should provide a process for mutual insurers to demutualise at their own discretion or if directed to do so by the supervisor.

6.3.2 The process for (de)mutualisation may vary by jurisdiction. For example, the ultimate approval may be provided by authorities other than the supervisor, such as courts or votes of member policyholders. Regardless, the supervisor should be consulted and should have the right to object to a (de)mutualisation.

6.3.3 In assessing a (de)mutualisation, the supervisor should consider the impact on the financial condition of the insurer and the ongoing expectations of policyholders, including those that will continue as participating policyholders. The supervisor should also assess whether the new governing organisational document of the company adequately protects current and future policyholders.

Portfolio Transfer

6.4 The supervisor assesses and decides on the transfer of all or a part of an insurer's business taking into account at least the financial condition of the transferee and the transferor and whether the interests of the policyholders of both the transferee and transferor will be protected.

6.4.1 Insurance policies are legal contracts between an insurer and its policyholders. As such, an insurer should not be able unilaterally to alter the terms of a contract by merging with another insurer, (de)mutualising, or transferring some of its business to another insurer.

6.4.2 In order to protect the interests of policyholders and to safeguard the financial condition of the insurers involved, legislation should address the conditions for a portfolio transfer. Policyholders' benefit expectations and existing policy values should not normally be lessened as a result of a portfolio transfer.

6.4.3 The process for a portfolio transfer may vary by jurisdiction. For example, the ultimate approval may be provided by authorities other than the supervisor, such as courts. Regardless, the supervisor should be consulted and should have the right to object to a portfolio transfer.

6.4.4 When assessing a transfer, the supervisor should consider the impact on the transferring policyholders, as well as on those that are not transferring, and those that are current policyholders of the company to which the policyholders are being transferred. This should apply whether the portfolio transfer is considered a part of normal business, a merger or part of a resolution where the insurer is no longer viable (see ICP 12 Exit from the Market and Resolution).

ICP 7 Corporate Governance[7]

The supervisor requires insurers to establish and implement a corporate governance framework which provides for sound and prudent management and oversight of the insurer's business and adequately recognises and protects the interests of policyholders.

Introductory Guidance

7.0.1 The corporate governance framework of an insurer:

- promotes the development, implementation and effective oversight of policies that clearly define and support the objectives of the insurer;
- defines the roles and responsibilities of persons accountable for the management and oversight of an insurer by clarifying who possesses legal duties and powers to act on behalf of the insurer and under which circumstances;
- sets requirements relating to how decisions and actions are taken including documentation of significant or material decisions, along with their rationale;
- provides sound remuneration practices which promote the alignment of remuneration policies with the long term interests of insurers to avoid excessive risk taking;
- provides for communicating with the supervisor, as appropriate, matters relating to the management and oversight of the insurer; and
- provides for corrective actions to be taken for non-compliance or weak oversight, controls or management.

7.0.2 An effective corporate governance framework enables an insurer to be flexible and transparent; to be responsive to developments affecting its operations in making timely decisions and to ensure that powers are not unduly concentrated. The corporate governance framework supports and enhances the ability of the key players responsible for an insurer's corporate governance; i.e. the Board, Senior Management and Key Persons in Control Functions to manage the insurer's business soundly and prudently.

Organisational structures

7.0.3 The insurer should establish a transparent organisational structure which supports the strategic objectives and operations of the insurer. The board and senior management should know and understand the structure and the risks that it poses.

[7] Amended November 2015

The ways in which an insurer chooses to organise and structure itself can vary depending on a number of factors such as:

- jurisdictional corporate law, which may allow or require different board structures (such as one-tier or two-tier Boards);
- organisational structure such as stock companies, mutuals or co-operatives; and
- group, branches, or solo legal entity operations.

These considerations can affect how an insurer establishes and implements its corporate governance framework and are explained in more detail below. It is important for supervisors to understand these different considerations in order to be able to adequately assess the effectiveness of an insurer's corporate governance framework.

7.0.4 The standards on corporate governance are designed with sufficient flexibility to apply to supervision of insurers regardless of any differences in the corporate structures and legal systems.

7.0.5 The term Board includes its management and oversight roles, regardless of Board structure.

Mutuals and co-operatives

7.0.6 Governance of insurers formed as mutuals or co-operatives is different from that of insurers formed as joint stock companies (i.e., bodies corporate). These standards are nevertheless sufficiently flexible to be adapted to mutuals and co-operatives to promote the alignment of actions and interests of the Board and Senior Management with the broader interests of policyholders. Where there are references to shareholders or stakeholders, they should be generally treated as references to policyholders in mutuals, unless otherwise indicated.

Insurance Groups

7.0.7 Insurance groups should ensure that the corporate governance framework is appropriate to the structure, business and risks of the insurance group and its legal entities. The corporate governance framework should include policies, processes and controls which address risks across the insurance group and legal entities.

7.0.8 When setting up or evaluating their corporate governance framework, insurance groups should be aware of the specific challenges which might arise from the organisational model adopted by a group (e.g. centralised or decentralised model). The main factors underlying the challenges are:

- the division of authorities and responsibilities between the key players at the insurance group and legal entity level;
- effective group-wide direction and coordination;
- proper consideration of the legal obligations, governance responsibilities and risks both at the insurance group and legal entity level; and

- effective communication within the group and adequate information at all levels.[8]

7.0.9 The supervisor should take the organisational structure of the group into consideration in evaluating its governance. Particularly when the management structure differs from the legal entity structure, it is not sufficient to assess governance only at the legal entity level. In such a case, it is important that appropriate governance exists across the group and that the supervisor assesses it on a group-wide basis.

Branch operations

7.0.10 If an insurer is a branch, these standards would generally apply to the legal entity in its home jurisdiction. However, the host supervisor may require designated oversight and/or management accountabilities and structures to be maintained at the branch, including in some cases a designated representative responsible for the management of the branch. In such cases, these standards should also apply, as appropriate, to the oversight and management roles maintained within the branch taking due account of the governance structures and arrangements as determined by the host supervisor.

Appropriate allocation of oversight and management responsibilities

7.1 The supervisor requires the insurer's Board to:

- **ensure that the roles and responsibilities allocated to the Board, Senior Management and Key Persons in Control Functions are clearly defined so as to promote an appropriate separation of the oversight function from the management responsibilities; and**
- **provide oversight of the Senior Management.**

7.1.1 The Board should ensure that the insurer has a well-defined governance structure which provides for the effective separation between oversight and management functions. The Board is responsible for providing the overall strategy and direction for the insurer and overseeing its proper overall management, while leaving the day-to-day management of the insurer to Senior Management. The separation of the roles of the Chair of the Board and the Chief Executive Officer (CEO) reinforces a clear distinction between accountability for oversight and management.

7.1.2 The Board should also ensure that there is a clear allocation of roles and responsibilities to the Board as a whole, to committees of the Board where they exist, and to the Senior Management and Key Persons in Control Functions to ensure proper oversight and sound management of the insurer. The allocation of roles and responsibilities should clearly identify the individual and collective accountabilities for the discharge of the respective roles and responsibilities. The organisational structure of the insurer and the assignment of responsibilities should enable the

[8] See Issues Paper, Approaches to Group Corporate Governance; Impact on Control Functions, October 2014.

Board and Senior Management to carry out their roles in an adequate and objective manner and should facilitate effective decision making.

7.1.3 The allocation of responsibilities to individual Board members (for example the membership of Board committees such as the audit or remuneration committee) should take due account of whether the relevant member has the degree of independence and objectivity required to carry out the functions of the particular committee. The effective oversight of the executive functions should be performed by the non-executive members of the Board, because they are not involved in the day-to-day management of the insurer. Within a group the allocation and division of the oversight and management responsibilities at different levels should be transparent, appropriate for, and aligned with, the organisational model of the group.[9]

7.1.4 In order to provide effective oversight of the Senior Management, the Board should:

- ensure that there are adequate policies and procedures relating to the appointment, dismissal and succession of the Senior Management, and be actively involved in such processes;
- ensure that Senior Management's knowledge and expertise remain appropriate given the nature of the business and the insurer's risk profile;
- monitor whether the Senior Management is managing the affairs of the insurer in accordance with the strategies and policies set by the Board, and the insurer's risk appetite, corporate values and corporate culture;
- set appropriate performance and remuneration standards for Senior Management consistent with the long-term strategy and the financial soundness of the insurer and monitor whether the Senior Management is meeting the performance goals set by the Board;
- regularly meet with the Senior Management to discuss and review critically the decisions made, information provided and any explanations given by the Senior Management relating to the business and operations of the insurer; and
- have regular interaction with any committee it establishes as well as with other key functions, proactively request information from them and challenge that information when necessary.

7.1.5 As a part of its regular monitoring and review of the insurer's operations, the Board should review whether the relevant policies and procedures, as set by the Board, are being properly implemented by Senior Management and are operating as intended. Particular attention should be paid as to whether the responsibilities for managing and implementing the policies of the Board have been effectively discharged by those responsible. The Board should obtain reports at least annually for this

[9] See Issues Paper, Approaches to Group Corporate Governance; impact on control functions, October 2014, para 43-44.

purpose and such reports may include internal or external independent reports as appropriate.

Corporate culture, business objectives and strategies of the insurer

7.2 The supervisor requires the insurer's Board to set and oversee the implementation of the insurer's corporate culture, business objectives and strategies for achieving those objectives, in line with the insurer's long term interests and viability.

7.2.1 The Board should adopt a rigorous process for setting, approving, and overseeing the implementation of the insurer's overall business objectives and strategies, taking into account the long term financial safety and soundness of the insurer as a whole, the interests of its policyholders and other stakeholders, and the fair treatment of customers. The Board ensures that the Senior Management has adequately documented and communicated these objectives and strategies to the Key Persons in Control Functions and all other relevant staff.

7.2.2 The effective implementation of objectives and strategies should be supported by the corporate culture and by clear and objective performance goals and measures, taking due account of, among other things, the insurer's long term interests and viability and the interests of policyholders and other stakeholders. The Board should review the appropriateness of the goals and measures set.

7.2.3 A corporate culture reflects the fundamental corporate values and includes norms for responsible and ethical behaviour applicable to all employees of the insurer. The Board should take the lead in setting the appropriate tone at the top. This includes adherence to the corporate values by the Board and a strong risk culture avoiding excessive risk taking. The corporate values, norms and supporting policies should be communicated throughout the insurer. These are also reflected in the insurer's business objectives and strategies, and supported by professional standards and codes of ethics that set out what the insurer considers to be acceptable and unacceptable conduct. In this regard, the Board should take account of the interests of policyholders and other relevant stakeholders. In setting the tone at the top the Board should ensure that employees are aware that appropriate disciplinary or other actions will follow unacceptable behaviours.

7.2.4 The Board should ensure that the corporate culture promotes timely and frank discussion and escalation of problems to Senior Management or itself. The Board should set and oversee the implementation of transparent policies and processes which promote and facilitate that employees can communicate concerns or information about illegal or unethical behaviour confidentially and without reprisal directly or indirectly to the Board (e.g. whistle blower policy). The Board should determine how and by whom legitimate concerns shall be investigated and addressed (Senior Management, Board or an external party).

7.2.5 The Board should define and oversee the implementation of norms for responsible and ethical behaviour. It should not allow behaviour that would be incompatible with the protection of policyholders and that could lead to reputational risks or improper or illegal activity, such as financial

misreporting, fraud, money laundering, bribery and corruption. The norms for responsible and ethical behaviour should also make clear that employees are expected to conduct themselves ethically in addition to complying with laws, regulations and the insurer's policies.

7.2.6 The Board should ensure that the insurer's corporate governance framework and overall business objectives and strategies are reviewed at least annually to ensure that they have been properly implemented and that they remain appropriate in light of any material changes in the organisational structure, activities, strategy, and regulatory and other external factors. The Board should ensure more frequent reviews, for instance when an insurer embarks on a significant new business initiative (e.g. a merger or acquisition, or a material change in the direction with respect to the insurer's product portfolio, risk or marketing strategies), upon the introduction of a new type or class of risk or product or a decision to market products to a new class or category of clients, or following the occurrence of significant external or internal events which may potentially have a material impact on the insurer (including its financial condition, objectives and strategies) or the interests of its policyholders or other stakeholders.

Structure and governance of the Board

7.3 The supervisor requires the insurer's Board to have, on an on-going basis:

- **an appropriate number and mix of individuals to ensure that there is an overall adequate level of competence at the Board level commensurate with the governance structure;**
- **appropriate internal governance practices and procedures to support the work of the Board in a manner that promotes the efficient, objective and independent judgment and decision making by the Board; and**
- **adequate powers and resources to be able to discharge its duties fully and effectively.**

Board composition

7.3.1 The Board of an insurer should have a sufficient number of members who have relevant expertise among them as necessary to provide effective leadership, direction and oversight of the insurer's business to ensure it is conducted in a sound and prudent manner. For this purpose, the Board should collectively and individually have, and continue to maintain, including through training, necessary skills, knowledge and understanding of the insurer's business to be able to fulfil their roles. In particular, the Board should have, or have access to, knowledge and understanding of areas such as the lines of insurance underwritten by the insurer, actuarial and underwriting risks, finance, accounting, the role of control functions, investment analysis and portfolio management and obligations relating to fair treatment of customers. While certain areas of expertise may lie in some, but not all, members, the collective Board should have an adequate spread and level of relevant competencies and understanding as appropriate to the insurer's business.

7.3.2 Board members should have the commitment necessary to fulfil their roles, demonstrated by, for example, a sufficient allocation of time to the affairs of the insurer and reasonable limits on the number of Board memberships held within or outside the insurance group.

Board effectiveness

7.3.3 The Board should review, at least annually, its own performance to ascertain whether members collectively and individually remain effective in discharging the respective roles and responsibilities assigned to them and identify opportunities to improve the performance of the Board as a whole. The Board should implement appropriate measures to address any identified inadequacies, including any training programmes for Board members. The Board may also consider the use of external expertise from time to time to undertake its performance assessment where appropriate in order to enhance the objectivity and integrity of that assessment process.

Internal governance

7.3.4 The Board should have appropriate practices and procedures for its own internal governance, and ensure that these are followed and periodically reviewed to assess their effectiveness and adequacy. These may be included in organisational rules or by-laws, and should set out how the Board will carry out its roles and responsibilities. They should also cover a formal and documented process for nomination, selection and removal of Board members, and a specified term of office as appropriate to the roles and responsibilities of the Board member, particularly to ensure the objectivity of decision making and judgment. Appropriate succession planning should also form part of the Board's internal governance practices.

Chair of the Board

7.3.5 While the Board as a whole remains collectively responsible for the stewardship of the insurer, the Chair of the Board has the pivotal role of providing leadership to the Board for its proper and effective functioning. The role of the Chair of the Board should generally encompass responsibilities such as setting the Board's agenda, ensuring that there is adequate time allocated for the discussion of agenda items, especially if they involve strategic or policy decisions of significant importance, and promoting a culture of openness and debate by facilitating effective participation of non-executive and executive members and communication between them and also with the Senior Management and Key Persons in Control Functions. To promote checks and balances, it is good practice for the Chair of the Board to be a non-executive Board member and not serve as chair of any Board committee. In jurisdictions where the Chair of the Board is permitted to assume executive duties, the insurer should have measures in place to mitigate any adverse impact on the insurer's checks and balances.

Board committees

7.3.6 To support the effective discharge of the responsibilities of the Board, the Board should assess whether the establishment of committees of the Board is appropriate. Committees that a Board may commonly establish include audit, remuneration, ethics/compliance, nominations and risk management committees. Where committees are appointed, they should have clearly defined mandates and working procedures (including reporting to the Board), authority to carry out their respective functions, and a degree of independence and objectivity as appropriate to the role of the committee. The Board should consider occasional rotation of members and of the chairs of committees, or tenure limits to serve on a committee, as this can help to avoid undue concentration of power and promote fresh perspectives. If the functions of any committees are combined, the Board should ensure such a combination does not compromise the integrity and/or effectiveness of the functions combined. In all cases, the Board remains ultimately responsible for matters delegated to any such committees.

Independence and objectivity

7.3.7 To promote objectivity in decision making by the Board, the formal and perceived independence of Board members should be ensured. To that end, Board members should avoid personal ties or financial or business interests which conflict with that of the insurer. Where it is not reasonably possible to avoid conflicts of interests, such conflicts should be effectively managed. Documented procedures and policies should be in place to identify and address conflicts of interests which could include disclosure of potential conflicts of interests, requirements for arm's length transactions, abstention of voting and, where appropriate, prior approval by the Board or shareholders of professional positions or transactions.

7.3.8 Besides policies on conflicts of interests, the insurer should ensure objectivity in decision making by establishing clear and objective independence criteria which should be met by an adequate number of members of the Board (i.e. non-executive Board members). For this purpose, the independence criteria should also take account of group structures and other applicable factors. Meeting such criteria is particularly important for those Board members undertaking specific roles (such as members of the remuneration and audit committees) in which conflicts of interests are more likely to arise.

7.3.9 Objectivity in decision making is also promoted by independence of mind of the individual Board members. This means that a Board member should act without favour; provide constructive and robust challenge of proposals and decisions; ask for information when the member judges it necessary in the light of the issues; and avoid "group-think".

7.3.10 Board members should also bear in mind the duties of good faith and loyalty applicable to them at the individual level, as set out in Standard 7.4.

Board powers

7.3.11 To be able to discharge its role and responsibilities properly, the Board should have well-defined powers, which are clearly set out either in legislation and/or as part of the constituent documents of the insurer (such as the constitution, articles of incorporation, by-laws or internal/organisational rules). These should, at a minimum, include the power to obtain timely and comprehensive information relating to the management of the insurer, including direct access to relevant persons within the organisation for obtaining information, such as Senior Management and Key Persons in Control Functions.

Access to resources

7.3.12 Adequate resources, such as sufficient funding, staff and facilities, should be allocated to the Board to enable the Board members to carry out their respective roles and responsibilities efficiently and effectively. The Board should have access to services of external consultants or specialists where necessary or appropriate, subject to criteria (such as independence) and due procedures for appointment and dismissal of such consultants or specialists.

Delegations

7.3.13 The Board may delegate some of the activities or tasks associated with its own roles and responsibilities. (Delegations in this context are distinguished from outsourcing of business activities by the insurer, which is dealt with in ICP 8 Risk Management and Internal Controls.) Notwithstanding such delegations, the Board as a whole retains the ultimate responsibility for the activities or tasks delegated, and the decisions made in reliance on any advice or recommendations made by the persons or committees to whom the tasks were delegated.

7.3.14 Where the Board makes any delegations, it should ensure that:

- the delegation is appropriate. Any delegation that results in the Board not being able to discharge its own roles and responsibilities effectively would be an undue or inappropriate delegation. For example, the duty to oversee the Senior Management should not be delegated to a Board committee comprised mostly or solely of executive members of the Board who are involved in the day-to-day management of the insurer;
- the delegation is made under a clear mandate with well-defined terms such as those relating to the powers, accountabilities and procedures relating to the delegation, and is supported by adequate resources to effectively carry out the delegated functions;
- there is no undue concentration of powers giving any one person or group of individuals an unfettered and inappropriate level of powers capable of influencing the insurer's business or management decisions;
- it has the ability to monitor and require reports on whether the delegated tasks are properly carried out; and

- it retains the ability to withdraw the delegation if it is not discharged properly and for due purposes by the delegate, and, for this purpose, have appropriate contingency arrangements in place.

Duties of individual Board members

7.4 The supervisor requires that an individual member of the Board:

- **act in good faith, honestly and reasonably;**
- **exercise due care and diligence;**
- **act in the best interests of the insurer and policyholders, putting those interests ahead of his/her own interests;**
- **exercise independent judgment and objectivity in his/her decision making, taking due account of the interests of the insurer and policyholders; and**
- **not use his/her position to gain undue personal advantage or cause any detriment to the insurer.**

7.4.1 The specific duties identified above are designed to address conflicts of interests that arise between the interests of the individual members of the Board and those of the insurer and policyholders. The insurer should include these duties as part of the terms of engagement of the individual Board members.

7.4.2 The supervisor should be satisfied that individual Board members understand the nature and scope of their duties and how they impact on the way in which the member discharges his/her respective roles and responsibilities. A Board member should consider his/her ability to discharge the roles and responsibilities in a manner as would be expected of a reasonably prudent person placed in a similar position. He/she should act on a fully informed basis, and for this purpose continually seek and acquire information as necessary.

7.4.3 Where a member of the Board of an insurer has common membership on the Board of any other entity within or outside the insurer's group, there should be clear and well defined procedures regarding the member's duty of loyalty to the insurer. These may include appropriate disclosure and in some instances shareholder approval of such overlapping roles. In the event of a material conflict with the interests of the insurer, the member should disclose such conflicts promptly to the Board of the insurer and its stakeholders as appropriate, and be required to decline to vote or take any decisions in any matters in which he/she has an interest.

Duties related to risk management and internal controls

7.5 The supervisor requires the insurer's Board to provide oversight in respect of the design and implementation of risk management and internal controls.

7.5.1 It is the Board's responsibility to ensure that the insurer has appropriate systems and functions for risk management and internal controls and to provide oversight to ensure that these systems and the functions that oversee them are operating effectively and as intended. The

responsibilities of the Board are described further in ICP 8 (Risk Management and Internal Controls).

Duties related to remuneration

7.6 The supervisor requires the insurer's Board to:

- **adopt and oversee the effective implementation of a written remuneration policy for the insurer, which does not induce excessive or inappropriate risk taking, is in line with the corporate culture, objectives, strategies, identified risk appetite, and long term interests of the insurer, and has proper regard to the interests of its policyholders and other stakeholders; and**
- **ensure that such a remuneration policy, at a minimum, covers those individuals who are members of the Board, Senior Management, Key Persons in Control Functions and other employees whose actions may have a material impact on the risk exposure of the insurer (major risk–taking staff).**

7.6.1 Sound remuneration policy and practices are part of the corporate governance of an insurer. This standard and guidance are neither intended to unduly restrict nor reduce an insurer's ability to attract and retain skilled talent by prescribing any particular form or level of individual remuneration. Rather, they aim to promote the alignment of remuneration policies with the long term interests of insurers to avoid excessive risk taking, thereby promoting sound overall governance of insurers and fair treatment of customers.

Overall remuneration strategy and oversight

7.6.2 As a part of effective risk management, an insurer should adopt and implement a prudent and effective remuneration policy. Such a policy should not encourage individuals, particularly members of the Board and Senior Management, Key Persons in Control Functions and major risk-taking staff, to take inappropriate or excessive risks, especially where performance-based variable remuneration is used.

7.6.3 The Board, particularly members of the remuneration committee where one exists, should collectively have the requisite competencies to make informed and independent judgments on the suitability of an insurer's remuneration policy. Such competencies include skills, such as a sufficient understanding of the relationship between risk and remuneration practices. The remuneration committee, where established, should have an adequate representation of non-executive members to promote objectivity in decision-making.

7.6.4 In order to satisfy itself about the effectiveness of the remuneration policy and practices, the Board should consider at least:

- the components of the overall remuneration policy, particularly the use and balance of fixed and variable components;
- the performance criteria and their application for the purposes of determining remuneration payments;

- the remuneration of the members of the Board, Senior Management and major risk-taking staff; and
- any reports or disclosures on the insurer's remuneration practices provided to the supervisor or the public.

7.6.5 The Board should ensure that in structuring, implementing and reviewing the insurer's remuneration policy, the decision-making process identifies and manages conflicts of interests and is properly documented. Members of the Board should not be placed in a position of actual or perceived conflicts of interests in respect of remuneration decisions.

7.6.6 The Board should also ensure that the relevant Key Persons in Control Functions are involved in the remuneration policy-setting and monitoring process to ensure that remuneration practices do not create incentives for excessive or inappropriate risk taking, are carried out consistently with established policies and promote alignment of risks and rewards across the organisation. Similarly, the remuneration and risk management committees of the Board, if such committees exist, should interact closely with each other and provide input to the Board on the incentives created by the remuneration system and their effect on risk-taking behaviour.

7.6.7 The potential for conflicts of interests that may compromise the integrity and objectivity of the staff involved in control functions should be mitigated. This can be achieved by a variety of means, such as making their remuneration:

- predominantly based on the effective achievement of the objectives appropriate to such control functions. Performance measures for staff in control functions should represent the right balance between objective assessments of the control environment (e.g. the conduct of the relationship between the control functions and executive management) and outputs delivered by the control functions, including their impact, quality and efficiency in supporting the oversight of risks. Such output measures may include recommendations made and implemented to reduce risks, reduction in number of compliance breaches and measures adopted to promptly rectify identified breaches, results of external quality reviews and losses recovered or avoided through audits of high risk areas;
- not linked to the performance of any business units which are subject to their control or oversight. For example, where risk and compliance functions are embedded in a business unit, a clear distinction should be drawn between the remuneration policy applicable to staff undertaking control functions and other staff in the business unit, such as through the separation of the pools from which remuneration is paid to the two groups of staff; and
- adequate as an overall package to attract and retain staff with the requisite skills, knowledge and expertise to discharge those control functions effectively and to increase their competence and performance.

7.6.8 Where any control function is outsourced, the remuneration terms under the agreement with the service provider should be consistent with the objectives and approved parameters of the insurer's remuneration policy.

Variable remuneration

7.6.9 Variable remuneration should be performance-based using measures of individual, unit or group performance that do not create incentives for inappropriate risk taking.

7.6.10 To better align performance-based incentives with the long term value creation and the time horizon of risks to which the insurer may be exposed, due consideration should be given to the following:

- There should be an appropriate mix of fixed and variable components, with adequate parameters set for allocating cash versus other forms of remuneration, such as shares. A variable component linked to performance that is too high relative to the fixed component may make it difficult for an insurer to reduce or eliminate variable remuneration in a poor financial year;
- The reward for performance should include an adjustment for the material current and future risks associated with performance. Since the time horizon of performance and associated risks can vary, the measurement of performance should, where practicable, be set in a multi-year framework to ensure that the measurement process is based on longer term performance;
- If the variable component of remuneration is significant, the major part of it should be deferred for an appropriate specified period. The deferral period should take account of the time frame within which risks associated with the relevant performance (such as the cost of capital required to support risks taken and associated uncertainties in the timing and the likelihood of future revenues and expenses) may materialise. The deferral period applied may vary depending on the level of seniority or responsibility of the relevant individuals and the nature of risks to which the insurer is exposed;
- The award of variable remuneration should contain provisions that enable the insurer, under certain circumstances, to apply malus or claw back arrangements in the case of subdued or negative financial performance of the insurer which is attributed to the excessive risk taking of the staff concerned and when risks of such performance have manifested after the award of variable remuneration; and
- Guaranteed variable remuneration should generally not be offered, as they are not consistent with sound risk management and performance-based rewards.

7.6.11 The variable component should be subject to prudent limits set under the remuneration policy that are consistent with the insurer's capital management strategy and its ability to maintain a sound capital base

taking account of the internal capital targets or regulatory capital requirements of the insurer.

7.6.12 The performance criteria applicable to the variable components of remuneration should promote a complete assessment of risk-adjusted performance. For this purpose, due consideration should be given to the need for performance criteria to:

- be clearly defined and be objectively measurable;
- be based not only on financial but also on non-financial criteria as appropriate (such as compliance with regulation and internal rules, achievement of risk management goals, adequate and timely follow up of internal audit recommendations as well as compliance with market conduct standards and fair treatment of customers;
- take account of not only the individual's performance, but also the performance of the business unit concerned where relevant and the overall results of the insurer and the group; and
- not treat growth or volume as a criterion in isolation from other performance criteria.

Share-based components

7.6.13 Where share-based components of variable remuneration (such as shares, share options or similar instruments) are used, appropriate safeguards should be implemented to align incentives and the longer-term interests of the insurer. Such safeguards may include that:

- shares do not vest for a minimum specified period after their award ("vesting restrictions");
- share options or other similar rights are not exercisable for a minimum specified period after their award ("holding restrictions"); and
- individuals are required to retain an appropriate proportion of the shares awarded until the end of their employment or other specified period beyond their employment ("retention restrictions").

7.6.14 Subject to any applicable legal restrictions, it is appropriate that future vesting and holding restrictions for share-based remuneration remain operative even upon cessation of employment (i.e. there should be no undue acceleration of the vesting of share-based payments or curtailing of any holding restrictions).

Severance payments

7.6.15 Where an insurer provides discretionary pay-outs on termination of employment ("severance payments", sometimes also referred to as "golden parachutes"), such payment should be subject to appropriate governance controls and limits. In any case, such pay-outs should be aligned with the insurer's overall financial condition and performance over an appropriate time horizon. Severance payments should be related to

performance over time; should not reward failure and should not be payable in the case of failure or threatened failure of the insurer, particularly to an individual whose actions have contributed to the failure or potential failure of the insurer.

Reliable and transparent financial reporting

7.7 The supervisor requires the insurer's Board to ensure there is a reliable financial reporting process for both public and supervisory purposes that is supported by clearly defined roles and responsibilities of the Board, Senior Management and the external auditor.

7.7.1 The Board is responsible for overseeing the insurer's systems and controls to ensure that the financial reports of the insurer present a balanced and accurate assessment of the insurer's business and its general financial health and viability as a going concern.

The Board carries out functions including:

- overseeing the financial statements, financial reporting and disclosure processes;
- monitoring whether accounting policies and practices of the insurer are operating as intended;
- overseeing the internal audit process (reviews by internal audit of the insurer's financial reporting controls) and reviewing the internal auditor's plans and material findings; and
- reporting to the supervisor on significant issues concerning the financial reporting process, including actions taken to address or mitigate identified financial reporting risks.

7.7.2 The Board should ensure that significant findings and observations regarding weaknesses in the financial reporting process are promptly rectified. This should be supported by a formal process for reviewing and monitoring the implementation of recommendations by the external auditor.

External Audit

7.8 The supervisor requires the insurer's Board to ensure that there is adequate governance and oversight of the external audit process.

7.8.1 The Board should ensure that the insurer:

- applies robust processes for approving, or recommending for approval, the appointment, reappointment, removal and remuneration of the external auditor;
- applies robust processes for monitoring and assessing the independence of the external auditor and to ensure that the appointed external auditor has the necessary knowledge, skills, expertise, integrity and resources to conduct the audit and meet any additional regulatory requirements;

- monitors and assesses the effectiveness of the external audit process throughout the audit cycle;
- investigates circumstances relating to the resignation or removal of an external auditor, and ensuring prompt actions are taken to mitigate any identified risks to the integrity of the financial reporting process, and
- reports to the supervisor on circumstances relating to the resignation or removal of the external auditor.

7.8.2 The Board should oversee the external audit process and safeguard and promote an effective relationship with the external auditor. For this purpose the Board should ensure that:

- the terms of engagement of the external auditor are clear and appropriate to the scope of the audit and resources required to conduct the audit and specify the level of audit fees to be paid;
- the auditor undertakes a specific responsibility under the terms of engagement to perform the audit in accordance with relevant local and international audit standards;
- the external auditor complies with internationally accepted ethical and professional standards and, where applicable, the more stringent requirements applicable to audits of listed entities and public interest entities;
- there are adequate policies and a process to ensure the independence of the external auditor, including:
  - restrictions and conditions for the provision of non-audit services which are subject to approval by the Board;
  - periodic rotation of members of the audit team and/or audit firm as appropriate; and
  - safeguards to eliminate or reduce to an acceptable level identified threats to the independence of the external auditor.
- there is adequate dialogue with the external auditor on the scope and timing of the audit to understand the issues of risk, information on the insurer's operating environment which is relevant to the audit, and any areas in which the Board may request for specific procedures to be carried out by the external auditor, whether as a part or an extension of the audit engagement; and
- there is unrestricted access by the external auditor to information and persons within the insurer as necessary to conduct the audit.

7.8.3 In order to establish the degree of assurance that the Board can draw from the external auditor's report, the Board should also understand the external auditor's approach to the audit. This includes the assessment of the external auditor's ability to:

- identify and assess the risks of material misstatement in the insurer's financial statements, taking into consideration the complexities of insurance activities and the need for insurers to have a strong control environment;
- respond appropriately to the significant risks of material misstatement in the insurer's financial statements; and
- develop appropriate relationships with the internal audit function and the actuarial function.

The Board should take appropriate actions where doubts arise as to the reliability of the external audit process.

7.8.4 In order to enable the Board to carry out its oversight responsibilities and to enhance the quality of the audit, the Board should have an effective communication with the external auditor. This should include:

- regular meetings between the Board and the external auditor during the audit cycle, including meetings without management present; and
- prompt communication of any information regarding internal control weaknesses or deficiencies of which the external auditor becomes aware.

The Board should require the external auditor to report to it on all relevant matters.

7.8.5 The supervisor and the external auditor should have an effective relationship that includes appropriate communication channels for the exchange of information relevant to carrying out their respective statutory responsibilities.

7.8.6 Reports prepared by the external auditor for the insurer (e.g. management letters) should be made available to the supervisor by the insurer or the external auditor.

7.8.7 The supervisor should require the external auditor to report matters that are likely to be of material significance. This would include material fraud, suspicion of material fraud and regulatory breaches or other significant audit findings identified in the course of the audit. Such information should be provided to the supervisor without the need for prior consent of the insurer and the external auditor should be duly protected from liability for any information disclosed to the supervisor in good faith.

7.8.8 The supervisor should require a further audit by a different external auditor where necessary.

Communications

7.9 The supervisor requires the insurer's Board to have systems and controls to ensure appropriate, timely and effective communications with the supervisor on the governance of the insurer.

7.9.1 Communications with the supervisor should promote effective engagement of the supervisor on the governance of the insurer to enable

informed judgments about the effectiveness of the Board and Senior Management in governing the insurer.

7.9.2 Subject to any reasonable commercial sensitivities and applicable privacy or confidentiality obligations, the insurer's communication policies and strategies should include providing to the insurer's stakeholders information such as the following:

- the insurer's overall strategic objectives, covering existing or prospective lines of business and how they are being or will be achieved;
- the insurer's governance structures, such as allocation of oversight and management responsibilities between the Board and the Senior Management, and organisational structures, including reporting lines;
- members of the Board and any Board committees, including their respective expertise, qualifications, track-record, other positions held by such members, and whether such members are regarded as independent;
- processes in place for the Board to evaluate its own performance and any measures taken to improve the Board's performance;
- the general design, implementation and operation of the remuneration policy;
- major ownership and group structures, and any significant affiliations and alliances; and
- material related-party transactions.

7.9.3 In addition to information publicly available, the supervisor may require more detailed and additional information relating to the insurer's corporate governance for supervisory purposes, which may include commercially sensitive information, such as assessments by the Board of the effectiveness of the insurer's governance system, internal audit reports and more detailed information on the remuneration structures adopted by the insurer for the Board, Senior Management, Key Persons in Control Functions and major risk-taking staff. The insurer's communication policies and strategies should enable such information to be provided to the supervisor in a timely and efficient manner. Supervisors should safeguard such information having due regard to the confidentiality of commercially sensitive information and applicable laws.

7.9.4 Disclosure of information on remuneration should be sufficient to enable stakeholders to evaluate how the remuneration system relates to risk and whether it is operating as intended. Relevant information may include:

- the operation of risk adjustments, including examples of how the policy results in adjustments to remuneration for employees at different levels;
- how remuneration is related to performance (both financial and personal business conduct) over time; and

- valuation principles in respect of remuneration instruments.

7.9.5 Appropriate quantitative information should also be made available to enable supervisors to evaluate the financial impact of the remuneration policy. Such information may include:

- the total cost of remuneration awarded in the period, analysed according to the main components such as basic salary, variable remuneration and long-term awards;
- the total amount set aside in respect of deferred variable remuneration;
- adjustment to net income for the period in respect of variable remuneration awarded in previous periods;
- the total costs of all sign-on payments in the period and number of individuals to whom these relate; and
- the total costs of all severance payments in the period and number of individuals to whom these relate.

These amounts should be analysed by type of instrument (e.g. cash, shares, share options etc.) as applicable, and in a manner consistent with the key elements of the remuneration policy.

7.9.6 Disclosure of information on governance should be made on a regular (for instance, at least annually) and timely basis.

Duties of Senior Management

7.10 The supervisor requires the insurer to ensure that Senior Management:

- **carries out the day-to-day operations of the insurer effectively and in accordance with the insurer's corporate culture, business objectives and strategies for achieving those objectives in line with the Insurer's long term interests and viability;**
- **promotes sound risk management, compliance and fair treatment of customers;**
- **provides the Board adequate and timely information to enable the Board to carry out its duties and functions including the monitoring and review of the performance and risk exposures of the insurer, and the performance of Senior Management; and**
- **maintains adequate and orderly records of the internal organisation.**

7.10.1 Senior Management should implement appropriate systems and controls, in accordance with the established risk appetite and corporate values and consistent with internal policies and procedures.

7.10.2 Such systems and controls should provide for organisation and decision-making in a clear and transparent manner that promotes effective management of the insurer. Senior Management's systems and controls should encompass:

- processes for engaging persons with appropriate competencies and integrity to discharge the functions under Senior Management, which include succession planning, on-going training and procedures for termination;
- clear lines of accountability and channels of communication between persons in Senior Management and Key Persons in Control Functions;
- proper procedures for the delegation of Senior Management functions and monitoring whether delegated functions are carried out effectively and properly, in accordance with the same principles that apply to delegations by the Board (see Guidance 7.3.13 and 7.3.14);
- standards of conduct and codes of ethics for the Senior Management and other staff to promote a sound corporate culture, and the effective implementation on an on-going basis of standards and codes (see ICP 8 Risk Management and Internal Controls for conflicts of interest provisions);
- proper channels of communications, including clear lines of reporting, as between the individuals performing the functions of the Senior Management and the Board, including provisions dealing with whistleblower protection, and their effective implementation; and
- effective communication strategies with supervisors and stakeholders that include the identification of matters that should be disclosed, and to whom such disclosure should be made.

7.10.3 Adequate procedures should be in place for assessing the effectiveness of Senior Management's performance against the performance objectives set by the Board. For this purpose, annual assessments of their performance against set goals should be carried out at least annually, preferably by an independent party, a control function, or the Board itself. Any identified inadequacies or gaps should be addressed promptly and reported to the Board.

7.10.4 Senior Management should also promote strong risk management and internal controls through personal conduct and transparent policies. Senior Management should communicate throughout the insurer the responsibility of all employees in this respect. It should not interfere with the activities that control functions carry out in the rightful exercise of their responsibilities, including that of providing an independent view of governance, risk, compliance and control related matters.

Supervisory review

7.11 The supervisor requires the insurer to demonstrate the adequacy and effectiveness of its corporate governance framework.

7.11.1 The supervisor plays an important role by requiring the Board and Senior Management of the insurer to demonstrate that they are meeting the applicable corporate governance requirements, consistent with these standards, on an on-going basis. The onus for demonstrating, to the

satisfaction of the supervisor, that the corporate governance framework is effective and operates as intended rests with the insurer.

7.11.2 The Supervisor should assess through its supervisory review and reporting processes whether the insurer's overall corporate governance framework is effectively implemented and remains adequate (see ICP 9 Supervisory Review and Reporting).

7.11.3 To help facilitate the supervisory review and reporting processes, the supervisor should establish effective channels of communication with the insurer, and have access to relevant information concerning the governance of the insurer. This may be obtained through periodic reports to the supervisor and any information obtained on an ad-hoc basis (see also Standard 7.7). Communication may also be facilitated by the supervisor having regular interaction with the Board, Senior Management and Key Persons in Control Functions.

7.11.4 The supervisor should assess the governance effectiveness of the Board and Senior Management and determine the extent to which their actions and behaviours contribute to good governance. This includes the extent to which the Board and Senior Management contribute to setting and following the "tone at the top;" how the corporate culture of the insurer is communicated and put into practice; how information flows to and from the Board and Senior Management; and how potential material problems are identified and addressed throughout the insurer.

7.11.5 To ascertain the on-going effectiveness of the Board and Senior Management, the supervisor may also consider the use of measures such as the following, where appropriate:

- on-going mandatory training that is commensurate with their respective duties, roles and responsibilities of the Board and Senior Management within the insurer;
- a review of the periodic self-evaluation undertaken by the Board as referred to in Guidance 7.3.3 and 7.11.1;
- meetings and/or interviews with the Board and Senior Management, both collectively and individually as appropriate, particularly to reinforce expectations relating to their performance and to get a sense of how informed and proactive they are; and
- attending and observing Board proceedings.

7.11.6 Where remuneration policies of an insurer contain more high risk elements, closer supervisory scrutiny of those policy and practices may also be warranted, including requests for additional information as appropriate to assess whether those practices are having an adverse impact on the on-going viability of the insurer or commissioning an independent assessment of the insurer's remuneration policy and practices.

ICP 8 Risk Management and Internal Controls[10]

The supervisor requires an insurer to have, as part of its overall corporate governance framework, effective systems of risk management and internal controls, including effective functions for risk management, compliance, actuarial matters and internal audit.

Introductory Guidance

8.0.1 As part of the overall corporate governance framework and in furtherance of the safe and sound operation of the insurer and the protection of policyholders, the Board is ultimately responsible for ensuring that the insurer has in place effective systems of risk management and internal controls and functions to address the key risks it faces and for the key legal and regulatory obligations that apply to it. Senior Management effectively implements these systems and provides the necessary resources and support for these functions.

8.0.2 In some jurisdictions, risk management is considered a subset of internal controls, while other jurisdictions would see it the other way around. The two systems are in fact closely related. Where the boundary lies between risk management and internal controls is less important than achieving, in practice, the objectives of each.

8.0.3 The systems and functions should be adequate for the insurer's objectives, strategy, risk profile, and the applicable legal and regulatory requirements. They should be adapted as the insurer's business and internal and external circumstances change.

8.0.4 The nature of the systems that the insurer has is dependent on many factors. The systems typically include:

- strategies setting out the approach of the insurer for dealing with specific areas of risk and legal and regulatory obligation;
- policies defining the procedures and other requirements that members of the Board and employees need to follow;
- processes for the implementation of the insurer's strategies and policies;
- and controls to ensure that such strategies, policies and processes are in fact in place, are being observed and are attaining their intended objectives.

8.0.5 An insurer's functions (whether in the form of a person, unit or department) should be properly authorised to carry out specific activities relating to matters such as risk management, compliance, actuarial matters and internal audit. These are generally referred to as control functions.

[10] Amended November 2015

Special considerations for groups

8.0.6 Group wide risks may affect insurance legal entities within a group, while risks at the insurance legal entity level could also affect the group as a whole. To help address this, groups should have strong risk management and compliance culture across the group and at the insurance legal entity level. Thus, in addition to meeting group governance requirements, the group should take into account the obligations of its insurance legal entities to comply with local laws and regulations.

8.0.7 How a group's systems of risk management and internal controls are organised and operate will depend on the governance approach the group takes, i.e., a more centralised or a more decentralised approach (see IAIS Issues Paper on Approaches to Group Corporate Governance; impact on control functions, October 2014). Regardless of the governance approach, it is important that effective systems of risk management and internal controls exist and that risks are properly monitored and managed at the insurance legal entity level and on a group-wide basis.

8.0.8 Additionally, a group's governance approach will also affect the way in which its control functions are organised and operated. Coordination between the insurance legal entity and group control functions is important to help ensure overall effective systems of risk management and internal controls. Regardless of how the group control functions are organised and operated, the result should provide an overall view of the group-wide risks and how they should be managed.

8.0.9 Supervisors should require the establishment of comprehensive and consistent group governance and assess its effectiveness. While the group-wide supervisor is responsible for assessing the effectiveness of the group's systems of risk management and internal controls, the other involved supervisors undertake such assessments on a legal entity basis. Appropriate supervisory cooperation and coordination is necessary to have a group-wide view and to enhance the assessment of the legal entities.

Systems for risk management and internal controls

8.1 The supervisor requires the insurer to establish, and operate within, an effective risk management system.

Basic components of a risk management system

8.1.1 The risk management system is designed and operated at all levels of the insurer to allow for the identification, assessment, monitoring, mitigation and reporting of all risks of the insurer in a timely manner. It takes into account the probability, potential impact and time horizon of risks.

8.1.2 An effective risk management system typically includes elements such as:

- a clearly defined and well documented risk management strategy, which includes a clearly defined risk appetite and takes

into account the insurer's overall business strategy and its business activities (including any business activities which have been outsourced);

- relevant objectives, key principles and proper allocation of responsibilities for dealing with risk across the business areas and business units of the insurer
- a documented process defining the Board approval required for any deviations from the risk management strategy or the risk appetite and for settling any major interpretation issues that may arise;
- appropriate documented policies that include a definition and categorisation of material risks (by type) to which the insurer is exposed, and the levels of acceptable risk limits for each type of these risk. These policies describe the risk standards and the specific obligations of employees and the businesses in dealing with risk, including risk escalation and risk mitigation tools;
- suitable processes and tools (including stress testing and, where appropriate, models) for identifying, assessing, monitoring and reporting on risks. Such processes should also cover contingency planning;
- regular reviews of the risk management system (and its components) to help ensure that necessary modifications and improvements are identified and made in a timely manner;
- appropriate attention to other matters set out in ICP (16 Enterprise Risk Management for Solvency Purposes); and
- an effective risk management function.

Scope and embedding of the risk management system

8.1.3 The risk management system should at least cover underwriting and reserving, asset-liability management, investments, liquidity and concentration risk management, operational risk management, conduct of business, and reinsurance and other risk-mitigation techniques.

8.1.4 The risk management system should be aligned with the insurer's risk culture and embedded into the various business areas and units with the aim of having the appropriate risk management practices and procedures embedded in the key operations and structures.

Identification

8.1.5 The risk management system should take into account all reasonably foreseeable and relevant material risks to which the insurer is exposed, both at the insurer and the individual business unit levels. This includes current and emerging risks.

8.1.6 Significant new or changed activities and products that may increase an existing risk or create a new type of exposure should be subject to appropriate risk review and be approved by the Board and Senior Management.

Assessment

8.1.7 Insurers should assess material risks both qualitatively and, where appropriate, quantitatively. Appropriate consideration should be given to a sufficiently wide range of outcomes, as well as to the appropriate tools and techniques to be used. The interdependencies of risks should also be analysed and taken into account in the assessments.

Monitoring

8.1.8 The risk management system should include early warnings or triggers that allows timely consideration of, and adequate response to, material risks. An insurer may decide to tolerate a risk, when it is acceptable within the risk appetite that has been set.

Mitigation

8.1.9 The risk management system should include strategies and tools to mitigate against material risks. In most cases an insurer will control or reduce the risk to an acceptable level. Another response to risk is to transfer the risk to a third party. If risks are not acceptable within the risk appetite and it is not possible to control, limit or transfer the risk, the insurer should cease or change the activity which creates the risk.

Reporting

8.1.10 Risks, the overall assessment of risks and the related action plans should be reported to the Board and/or to Senior Management, as appropriate, using qualitative and quantitative indicators and effective action plans. The insurer's documented risk escalation process should allow for reporting on risk issues within established reporting cycles and outside of them for matters of particular urgency.

8.1.11 The Board should have appropriate ways to carry out its responsibilities for risk oversight. The risk management policy should therefore cover the content, form and frequency of reporting that it expects on risk from Senior Management and each of the control functions. Any proposed activity that would go beyond the Board-approved risk appetite should be subject to appropriate review and require Board approval.

Risk Policies

8.1.12 The insurer's risk policies should be written in a way to help employees understand their risk responsibilities. They should also help explain the relationship of the risk management system to the insurer's overall corporate governance framework and to its corporate culture. The overall risk management policy of the insurer should outline how relevant and material risks are managed. Related policies should be established, either as elements of the risk management policy, or as separate sub-policies. At a minimum, these should include policies related to the risk appetite framework, an asset-liability management policy, an investment policy, and an underwriting risk policy.

8.1.13 Regular internal communications and training on risk policies should take place.

Changes to the risk management system

8.1.14 Both the Board and Senior Management should be attentive to the need to modify the risk management system in light of new internal or external circumstances.

8.1.15 Material changes to an insurer's risk management system should be documented and subject to approval by the Board. The reasons for the changes should be documented. Appropriate documentation should be available to internal audit, external audit and the supervisor for their respective assessments of the risk management system.

8.2 The supervisor requires the insurer to establish, and operate within, an effective system of internal controls.

Basic components of an internal controls system

8.2.1 The internal controls system should ensure effective and efficient operations, adequate control of risks, prudent conduct of business, reliability of financial and non-financial information reported (both internally and externally), and compliance with laws, regulations, supervisory requirements and the insurer's internal rules and decisions. It should be designed and operated to assist the Board and Senior Management in the fulfilment of their respective responsibilities for oversight and management of the insurer. Some insurers have a designated person or function to support the advancement, coordination and/or management of the overall internal controls system on a more regular basis.

8.2.2 The internal controls system should cover all units and activities of the insurer and should be an integral part of the daily activities of an insurer. The controls should form a coherent system, which should be regularly assessed and improved as necessary. Each individual control[11] of an insurer, as well as all its controls cumulatively, should be designed for effectiveness and operate effectively.

8.2.3 An effective internal control system requires an appropriate control structure with control activities defined at every business unit level. Depending on the organisational structure of the insurer, business or other units should own, manage and report on risks and should be primarily accountable for establishing and maintaining effective internal control policies and procedures. Control functions should determine and assess the appropriateness of the controls used by the business or other units. The internal audit function should provide independent assurance on the quality and effectiveness of the internal controls system.[12]

[11] Individual controls may be preventive (applied to prevent undesirable outcomes) or detective (to uncover undesirable activity). Individual controls may be manual (human), automated, or a combination and may be either general or process or application specific.

[12] This division of responsibilities between business, risk management and compliance and internal audit is typically referred to as the three lines of defense. The business is considered as the first line

8.2.4 An effective internal controls system typically includes:

Segregation of duties and prevention of conflicts of interest

- appropriate segregation of duties and controls to ensure such segregation is observed. This includes, amongst others, having sufficient distance between those accountable for a process or policy and those who check if for such a process or policy an appropriate control exists and is being applied. It also includes appropriate distance between those who design a control or operate a control and those who check if such a control is effective in design and operation;
- up-to-date policies regarding who can sign for or commit the insurer, and for what amounts, with corresponding controls, such as practice that key decisions should be taken at least by two persons and the practice of double or multiple signatures. Such policies and controls should be designed, among other things, to prevent any major transaction being entered into without appropriate governance review or by anyone lacking the necessary authority and to ensure that borrowing, trading, risk and other such limits are strictly observed. Such policies should foresee a role for control functions, for example by requiring for major matters the review and sign-off by Risk Management or Compliance, and/or approval by a Board level committee;

Policies and processes

- appropriate controls for all key business processes and policies, including for major business decisions and transactions (including intra-group transactions), critical IT functionalities, access to critical IT infrastructure by employees and related third parties, and important legal and regulatory obligations;
- policies on training in respect of controls, particularly for employees in positions of high trust or responsibility or involved in high risk activities;
- a centralised documented inventory of insurer-wide key processes and policies and of the controls in place in respect of such processes and policies, that also may introduce a hierarchy among the policies;

Information and communication

- appropriate controls to provide reasonable assurance over the accuracy and completeness of the insurer's books, records, and accounts and over financial consolidation and reporting, including the reporting made to the insurer's supervisors;

of defence, the control functions (other than internal audit) as the second line of defence, and internal audit as the third line of defence. The business is deemed to "own" the controls, and the other lines of defence are there to help ensure their application and viability. Whatever approach is used, it is important that responsibilities be clearly allocated to promote checks and balances and avoid conflicts of interest.

- adequate and comprehensive internal financial, operational and compliance data, as well as external market information about events and conditions that are relevant to decision making. Information should be reliable, timely, accessible, and provided in a consistent format;
- information processes that cover all significant activities of the insurer, including contingency arrangements;
- effective channels of communication to ensure that all staff fully understand and adhere to the internal controls and their duties and responsibilities and that other relevant information is reaching the appropriate personnel;
- policies regarding escalation procedures;

Monitoring and review

- processes for regularly checking that the totality of all controls forms a coherent system and that this system works as intended; fits properly within the overall corporate governance structure of the insurer; and provides an element of risk control to complement the risk identification, risk assessment, and risk management activities of the insurer. As part of such review, individual controls are monitored and analysed periodically to determine gaps and improvement opportunities with Senior Management taking such measures as are necessary to address these; and
- periodic testing and assessments (carried out by objective parties such as an internal or external auditor) to determine the adequacy, completeness and effectiveness of the internal controls system and its utility to the Board and Senior Management for controlling the operations of the insurer.

Responsibilities of the Board

8.2.5 The Board should have an overall understanding of the control environment across the various entities and businesses, and require Senior Management to ensure that for each key business process and policy, and related risks and obligations, there is an appropriate control.

8.2.6 In addition, the Board should ensure there is clear allocation of responsibilities within the insurer, with appropriate segregation, including in respect of the design, documentation, operation, monitoring and testing of internal controls. Responsibilities should be properly documented, such as in charters, authority tables, governance manuals or other similar governance documents.

8.2.7 The Board should determine which function or functions report to it or to any Board Committees in respect of the internal controls system.

Reporting

8.2.8 Reporting on the internal controls system should cover matters such as:

- the strategy in respect of internal controls (such as responsibilities, target levels of compliance to achieve, validations and implementation of remediation plans);
- the stage of development of the internal controls system, including its scope, testing activity, and the performance against annual or periodic internal controls system goals being pursued;
- an assessment of how the various business units are performing against internal control standards and goals;
- control deficiencies, weaknesses and failures that have arisen or that have been identified (including any identified by the internal or external auditors or the supervisor) and the responses thereto (in each case to the extent not already covered in other reporting made to the Board); and
- controls at the appropriate levels so as to be effective, including at the process or transactional level.

Control functions (general)

8.3 The supervisor requires the insurer to have effective control functions with the necessary authority, independence and resources.

8.3.1 As part of the effective systems of risk management and internal controls, insurers have control functions, including for risk management, compliance, actuarial matters and internal audit. Control functions add to the governance checks and balances of the insurer and provide the necessary assurance to the Board in the fulfilment of its oversight duties.

8.3.2 The existence of control functions does not relieve the Board or Senior Management of their respective governance and related responsibilities.

8.3.3 The control functions should be subject to periodic review either by the internal audit function (for control functions other than internal audit) or an objective external reviewer.

Appointment and dismissal of heads of control functions

8.3.4 The appointment, performance assessment, remuneration, discipline and dismissal of the head of control functions should be done with the approval of, or after consultation with, the Board or the relevant Board committee. For the head of the internal audit function, the appointment, performance assessment, remuneration, discipline and dismissal should be done by the Board, its Chair or the Audit Committee.

8.3.5 The insurer should notify the supervisor of the reasons for dismissals of heads of control functions.

Authority and independence of control functions

8.3.6 The Board should approve the authority and responsibilities of each control function to allow each control function to have the authority and independence necessary to be effective.

8.3.7 The authority and responsibilities of each control function should be set out in writing and made part of, or referred to in, the governance documentation of the insurer. The head of each control function should periodically review such document and submit suggestions for any changes to Senior Management and the Board for approval, where appropriate.

8.3.8 A control function should be led by a person of appropriate level of authority. The head of the control function should not have operational business line responsibilities.

8.3.9 Insurers should organise each control function and its associated reporting lines into the insurer's organisational structure in a manner that enables such function to operate and carry out their roles effectively. This includes direct access to the Board or the relevant Board committee.

8.3.10 Notwithstanding the possibility for insurers to combine certain control functions, a control function should be sufficiently independent from Senior Management and from other functions to allow its staff to:

- serve as a component of the insurer's checks and balances;
- provide an objective perspective on strategies, issues, and potential violations related to their areas of responsibility; and
- implement or oversee the implementation of corrective measures where necessary.

8.3.11 Each control function should avoid conflicts of interest. Where any conflicts remain and cannot be resolved with Senior Management, these should be brought to the attention of the Board for resolution.

8.3.12 Each control function should have the authority to communicate on its own initiative with any employee and to have unrestricted access to information in any business unit that it needs to carry out its responsibilities. The control functions should have the right to conduct investigations of possible breaches and to request assistance from specialists within the insurer, e.g. legal and internal audit, or engage external specialists to perform the task.

The control functions should be free to report to Senior Management or the Board on any irregularities or possible breaches disclosed by its investigations, without fear of retaliation or disfavour from management.

Resources and qualifications of the control functions

8.3.13 Each control function should have the resources necessary to fulfil its responsibilities and achieve the specific goals in its areas of responsibility. This includes qualified staff and appropriate IT/management information processes. The function should be organized in an appropriate manner to achieve its goals.

8.3.14 The head of each control function should review regularly the adequacy of the function's resources and request adjustments from Senior Management as necessary. Where the head of a control function has a major difference of opinion with Senior Management on the resources

needed, the head of the control function should bring the issue to the Board or relevant Board Committee for resolution.

8.3.15 Persons who perform control functions should be suitable for their role and meet any applicable professional qualifications and standards. Higher expectations apply to the head of each control function. Persons who perform control functions should receive regular training relevant to their role to remain up to date on the developments and techniques related to their areas of responsibility.

Board access and reporting by the control functions; Board assessment of control functions

8.3.16 The Board should grant the head of each control function the authority and responsibility to report periodically to it or one of its committees. The Board should determine the frequency and depth of such reporting so as to permit timely and meaningful communication and discussion of material matters. The reporting should include, among other things:

- information as to the function's strategy and longer term goals and the progress in achieving these;
- annual or other periodic operational plans describing shorter term goals and the progress in achieving these; and
- resources (such as personnel, budget, etc.), including an analysis on the adequacy of these resources.

8.3.17 In addition to periodic reporting, the head of each control function should have the opportunity to communicate directly and to meet periodically (without the presence of management) with the Chair of any relevant Board committee (e.g. Audit or Risk Committee) and/or with the Chair of the full Board. The Board should periodically assess the performance of each control function. This may be done by the full Board, by the Chair of the Board, by the relevant Board committee or by the Chair of the relevant Board committee.

Risk management function

8.4 The supervisor requires the insurer to have an effective risk management function capable of assisting the insurer to

- **identify, assess, monitor, mitigate and report on its key risks in a timely way; and**
- **promote and sustain a sound risk culture.**

8.4.1 A robust risk management function that is well positioned, resourced and properly authorised and staffed is an essential element of an effective risk management system. Within some insurers, and particularly at larger or more complex ones, the risk management function is typically led by a Chief Risk Officer.

Access and reporting to the Board by the risk management function

8.4.2 The risk management function should have access and provide written reports to the Board as required by the Board, typically on matters such as:

- an assessment of risk positions and risk exposures and steps being taken to manage them;
- an assessment of changes in the insurer's risk profile relative to risk appetite;
- where appropriate, an assessment of pre-defined risk limits;
- where appropriate, risk management issues resulting from strategic affairs such as corporate strategy, mergers and acquisitions and major projects and investments;
- an assessment of risk events and the identification of appropriate remedial actions.

8.4.3 The head of the risk management function should have the authority and obligation to inform the Board promptly of any circumstance that may have a material effect on the risk management system of the insurer.

Main activities of the risk management function

8.4.4 The risk management function should establish, implement and maintain appropriate mechanisms and activities including to:

- assist the Board and Senior Management in carrying out their respective responsibilities, including by providing specialist analyses and performing risk reviews;
- identify the individual and aggregated risks (actual, emerging and potential) the insurer faces;
- assess, aggregate, monitor and help manage and otherwise address identified risks effectively; this includes assessing the insurer's capacity to absorb risk with due regard to the nature, probability, duration, correlation and potential severity of risks;
- gain and maintain an aggregated view of the risk profile of the insurer both at a legal entity and/or group-wide level;
- establish a forward-looking assessment of the risk profile;
- evaluate the internal and external risk environment on an on-going basis in order to identify and assess potential risks as early as possible. This may include looking at risks from different perspectives, such as by territory or by line of business;
- consider risks arising from remuneration arrangements and incentive structures;
- conduct regular stress testing and scenario analyses as defined in ICP 16 (Enterprise Risk Management for Solvency Purposes);
- regularly provide written reports to Senior Management, Key Persons in Control Functions and the Board on the insurer's risk

profile and details on the risk exposures facing the insurer and related mitigation actions as appropriate;

- document and report material changes affecting the insurer's risk management system to the Board to help ensure that the system is maintained and improved; and
- conduct regular self-assessments and implement or monitor the implementation of any needed improvements.

Compliance function

8.5 The supervisor requires the insurer to have an effective compliance function capable of assisting the insurer to:

- **meet its legal, regulatory and supervisory obligations; and**
- **promote and sustain a compliance culture,**

including through the monitoring of related internal policies.

8.5.1 The compliance function has a broader role than merely monitoring compliance with laws and regulations and supervisory requirements; monitoring compliance with internal policies and promoting and sustaining a compliance culture within the insurer are equally important aspects of this control function.

8.5.2 Compliance starts at the top. The Board is ultimately responsible for establishing standards for honesty and integrity throughout the insurer and for creating an effective corporate culture that emphasises them. This should include a code of conduct or other appropriate mechanism as evidence of the insurer's commitment to comply with all applicable laws, regulations, supervisory requirements, and internal policies, and conduct its business ethically and responsibly.

8.5.3 As part of this commitment, the insurer has in place a robust and well positioned, resourced and properly authorised and staffed compliance function. Within some insurers, particularly larger or more complex ones, such a function is typically led by a Chief Compliance Officer.

Board access and reporting of the compliance function

8.5.4 The compliance function should have access and provide written reports to Senior management, key persons in control functions and the Board on matters such as:

- an assessment of the key compliance risks the insurer faces and the steps being taken to address them;
- an assessment of how the various parts of the insurer (e.g. divisions, major business units, product areas) are performing against compliance standards and goals;
- any compliance issues involving management or persons in positions of major responsibility within the insurer, and the status of any associated investigations or other actions being taken;

- material compliance violations or concerns involving any other person or unit of the insurer and the status of any associated investigations or other actions being taken; and
- material fines or other disciplinary actions taken by any regulator or supervisor in respect of the insurer or any employee.

8.5.5 The head of the compliance function should have the authority and obligation to inform promptly the Chair of the Board directly in the event of any major non-compliance by a member of management or a material non-compliance by the insurer with an external obligation if in either case he or she believes that Senior Management or other persons in authority at the insurer are not taking the necessary corrective actions and a delay would be detrimental to the insurer or its policyholders.

Main activities of the compliance function

8.5.6 The compliance function should establish, implement and maintain appropriate mechanisms and activities including to:

- promote and sustain an ethical corporate culture that values responsible conduct and compliance with internal and external obligations; this includes communicating and holding training on an appropriate code of conduct or similar that incorporates the corporate values of the insurer, aims to promote a high level of professional conduct and sets out the key conduct expectations of employees;
- identify, assess, report on and address key legal and regulatory obligations, including obligations to the insurer's supervisor, and the risks associated therewith; such analyses should use risk and other appropriate methodologies;
- ensure the insurer monitors and has appropriate policies, processes and controls in respect of key areas of legal, regulatory and ethical obligation;
- hold regular training on key legal and regulatory obligations particularly for employees in positions of high responsibility or who are involved in high risk activities;
- facilitate the confidential reporting by employees of concerns, shortcomings or potential or actual violations in respect of insurer internal policies, legal or regulatory obligations, or ethical considerations; this includes ensuring there are appropriate means for such reporting;
- address compliance shortcomings and violations, including ensuring that adequate disciplinary actions are taken and any necessary reporting to the supervisor or other authorities is made; and
- conduct regular self-assessments of the compliance function and the compliance processes and implement or monitor needed improvements.

Actuarial function

8.6 The supervisor requires the insurer to have an effective actuarial function capable of evaluating and providing advice regarding, at a minimum, technical provisions, premium and pricing activities, capital adequacy, reinsurance and compliance with related statutory and regulatory requirements.

8.6.1 A robust actuarial function that is well positioned, resourced and properly authorised and staffed is essential for the proper operation of the insurer. It plays a key role as part of the insurer's overall systems of risk management and internal controls.

Board access and reporting of the actuarial function

8.6.2 The actuarial function should have access to and periodically report to the Board on matters such as:

- any circumstance that may have a material effect on the insurer from an actuarial perspective;
- the adequacy of the technical provisions and other liabilities;
- distribution of profits to participating policyholders;
- stress testing and capital adequacy assessment with regard to the prospective solvency position of the insurer; and
- any other matters as determined by the Board.

8.6.3 Written reports on actuarial evaluations should be made to the Board, Senior Management, or other Key Persons in Control Functions or the supervisor as necessary or appropriate or as required by legislation.

Main activities of the actuarial function

8.6.4 The actuarial function evaluates and provides advice to the insurer on matters including:

- the insurer's insurance liabilities, including policy provisions and aggregate claim liabilities, as well as determination of reserves for financial risks;
- asset liability management with regards to the adequacy and the sufficiency of assets and future revenues to cover the insurer's obligations to policyholders and capital requirements, as well as other obligations or activities;
- the insurer's investment policies and the valuation of assets;
- an insurer's solvency position, including a calculation of minimum capital required for regulatory purposes and liability and loss provisions;
- an insurer's prospective solvency position by conducting capital adequacy assessments and stress tests under various scenarios, and measuring their relative impact on assets, liabilities, and actual and future capital levels;

- risk assessment and management policies and controls relevant to actuarial matters or the financial condition of the insurer;
- the fair treatment of policyholders with regard to distribution of profits awarded to participating policyholders;
- the adequacy and soundness of underwriting policies;
- the development, pricing and assessment of the adequacy of reinsurance arrangements;
- product development and design, including the terms and conditions of insurance contracts and pricing, along with estimation of the capital required to underwrite the product;
- the sufficiency, accuracy and quality of data, the methods and the assumptions used in the calculation of technical provisions;
- the research, development, validation and use of internal models for internal actuarial or financial projections, or for solvency purposes as in the ORSA; and
- any other actuarial or financial matters determined by the Board.

8.6.5 Where required, the actuarial function may also provide to the supervisor certifications on the adequacy, reasonableness and/or fairness of premiums (or the methodology to determine the same) and certifications or statements of actuarial opinion.

8.6.6 The supervisor should clearly define when such certifications or statements of actuarial opinion need to be submitted to the supervisor. When these are required to be submitted, the supervisor should also clearly define both the qualifications of those permitted to certify or sign such statements and the minimum contents of such an opinion or certification.

Appointed actuary

8.6.7 Some jurisdictions may require an "appointed actuary," "statutory actuary," or "responsible actuary" (referred to here as an "Appointed Actuary") to perform certain functions, such as determining or providing advice on an insurer's compliance with regulatory requirements for certifications or statements of actuarial opinion. The tasks and responsibilities of the Appointed Actuary should be clearly defined and should not limit or restrict the tasks and responsibilities of other individuals performing actuarial functions.

8.6.8 The insurer should be required to report the Appointed Actuary's appointment to the supervisor.

8.6.9 The Appointed Actuary should not hold positions within or outside of the insurer that may create conflicts of interest or compromise his or her independence. If the Appointed Actuary is not an employee of the insurer, the Board should determine whether the external actuary has any potential conflicts of interest, such as if his or her firm also provides auditing or other services to the insurer. If any such conflicts exist, the Board should subject them to appropriate controls or choose another Appointed Actuary.

8.6.10 If an Appointed Actuary is replaced, the insurer should notify the supervisor and give the reasons for the replacement. In some jurisdictions, such a notification includes statements from both the insurer and the former Appointed Actuary as to whether there were any disagreements with the former Appointed Actuary over the content of the actuary's opinion on matters of risk management, required disclosures, scopes, procedures, or data quality, and whether or not any such disagreements were resolved to the former Appointed Actuary's satisfaction.

8.6.11 In some jurisdictions, the Appointed Actuary also has the obligation to notify the supervisor if he or she resigns for reasons connected with his or her duties as an Appointed Actuary or with the conduct of the insurer's business and give the reasons for resigning. The Appointed Actuary should also notify the supervisor and provide an explanation if his or her appointment is revoked by the insurer.

8.6.12 The supervisor should have the authority to require an insurer to replace an Appointed Actuary when such person fails to adequately perform required functions or duties, is subject to conflicts of interest or no longer meets the jurisdiction's eligibility requirements.

Internal audit function

8.7 The supervisor requires the insurer to have an effective internal audit function capable of providing the Board with independent assurance in respect of the quality and effectiveness of the insurer's corporate governance framework.

8.7.1 One of the oversight roles of the Board is to ensure that the information provided by the internal audit function allows the Board to effectively validate the effectiveness of the internal control system.

8.7.2 The internal audit function should provide independent assurance to the Board through general and specific audits, reviews, testing and other techniques in respect of matters such as:

- the overall means by which the insurer preserves its assets and those of policyholders, and seeks to prevent fraud, misappropriation or misapplication of such assets;
- the reliability, integrity and completeness of the accounting, financial and risk reporting information, as well as the capacity and adaptability of IT architecture to provide that information in a timely manner to the Board and Senior management;
- the design and operational effectiveness of the insurer's individual controls in respect of the above matters, as well as of the totality of such controls (the internal controls system);
- other matters as may be requested by the Board, Senior Management, the supervisor or the external auditor; and
- other matters which the internal audit function determines should be reviewed to fulfil its mission, in accordance with its charter, terms of reference or other documents setting out its authority and responsibilities.

Authority and independence of the internal audit function

8.7.3 To help ensure objectivity, the internal audit function is independent from management and other control functions and is not involved operationally in the business. The internal audit function's ultimate responsibility is to the Board, not management. To help ensure independence and objectivity, the internal audit function should be free from conditions that threaten its ability to carry out its responsibilities in an unbiased manner. In carrying out its tasks, the internal audit function forms its judgments independently. If necessary, the internal audit function should consider the need to supplement its own assessment with third party expertise in order to make objective and independent decisions.

8.7.4 The Board should grant suitable authority to the internal audit function, including the authority to:

- access and review any records or information of the insurer which the internal audit function deems necessary to carry out an audit or other review;
- undertake on the internal audit function's initiative a review of any area or any function consistent with its mission;
- require an appropriate management response to an internal audit report, including the development of a suitable remediation, mitigation or other follow-up plan as needed; and
- decline doing an audit or review, or taking on any other responsibilities requested by management, if the internal audit function believes this is inconsistent with its mission or with the strategy and audit plan approved by the Board. In any such case, the internal audit function should inform the Board or the Audit Committee and seek their guidance.

Board access and reporting of the internal audit function

8.7.5 The head of the internal audit function reports to the Board (or to any member who is not part of the management) or to the Audit Committee if one exists (or its Chair). In its reporting, the internal audit function should cover matters such as:

- the function's annual or other periodic audit plan, detailing the proposed areas of audit focus, and any significant modifications to the audit plan;
- any factors that may be adversely affecting the internal audit function's independence, objectivity or effectiveness;
- material findings from audits or reviews conducted; and
- the extent of management's compliance with agreed upon corrective or risk mitigating measures in response to identified control deficiencies, weaknesses or failures, compliance violations or other lapses.

8.7.6 In addition to periodic reporting, the head of internal audit should be authorised to communicate directly, and meet periodically, with the head

of the Audit Committee or the Chair of the Board without management present.

Main activities of the internal audit function

8.7.7 The audit function should carry out such activities as are needed to fulfil its responsibilities. These activities include:

- establishing, implementing and maintaining a risk-based audit plan to examine and evaluate alignment of the insurer's processes with their risk culture;
- monitoring and evaluating the adequacy and effectiveness of the insurer's policies and processes and the documentation and controls in respect of these, on a legal entity and group-wide basis and on an individual subsidiary, business unit, business area, department or other organisational unit basis;
- reviewing levels of compliance by employees, organisational units and third parties with laws, regulations and supervisory requirements, established policies, processes and controls, including those involving reporting;
- evaluating the reliability, integrity and effectiveness of management information processes and the means used to identify, measure, classify and report such information;
- monitoring that identified risks are effectively addressed by the internal control system;
- evaluating the means of safeguarding insurer and policyholder assets and, as appropriate, verifying the existence of such assets and the required level of segregation in respect of insurer and policyholder assets;
- monitoring and evaluating the effectiveness of the insurer's control functions, particularly the risk management and compliance function; and
- coordinating with the external auditors and, to the extent requested by the Board and consistent with applicable law, evaluating the quality of performance of the external auditors.

8.7.8 In carrying out the above tasks, the internal audit function should ensure all material areas of risk and obligation of the insurer are subject to appropriate audit or review over a reasonable period of time. Among these areas are those dealing with:

- market, underwriting, credit, liquidity, operational, conduct of business, as well as reputational issues derived from exposure to those risks;
- accounting and financial policies and whether the associated records are complete and accurate;
- extent of compliance by the insurer with applicable laws, regulations, rules and directives from all relevant jurisdictions;

- intra-group transactions, including intra-group risk transfer and internal pricing;
- adherence by the insurer to the insurer's remuneration policy;
- the reliability and timeliness of escalation and reporting processes, including whether there are confidential means for employees to report concerns or violations and whether these are properly communicated, offer the reporting employee protection from retaliation, and result in appropriate follow up; and
- the extent to which any non-compliance with internal policies or external legal or regulatory obligations is documented and appropriate corrective or disciplinary measures are taken including in respect of individual employees involved.

8.7.9 Subject to applicable laws on record retention, the internal audit function should keep records of all areas and issues reviewed so as to provide evidence of these activities over time.

Outsourcing of material activities or functions

8.8 The supervisor requires the insurer to retain at least the same degree of oversight of, and accountability for, any outsourced material activity or function (such as a control function) as applies to non-outsourced activities or functions.

8.8.1 Outsourcing, should not materially increase risk to the insurer or materially adversely affect the insurer's ability to manage its risks and meet its legal and regulatory obligations.

8.8.2 The Board and Senior Management remain responsible in respect of functions or activities that are outsourced.

8.8.3 The supervisor should require the Board to have review and approval processes for outsourcing of any material activity or function and to verify, before approving, that there was an appropriate assessment of the risks, as well as an assessment of the ability of the insurer's risk management and internal controls to manage them effectively in respect of business continuity. The assessment should take into account to what extent the insurer's risk profile and business continuity could be affected by the outsourcing arrangement.

8.8.4 The supervisor should require insurers which outsource any material activity or function to have in place an appropriate policy for this purpose, setting out the internal review and approvals required and providing guidance on the contractual and other risk issues to consider. This includes considering limits on the overall level of outsourced activities at the insurer and on the number of activities that can be outsourced to the same service provider. Because of the particularly important role that control activities and control functions play in an insurer's corporate governance framework, the supervisor should consider issuing additional requirements for their outsourcing or dedicating more supervisory attention to any such outsourcing.

8.8.5 Outsourcing relationships should be governed by written contracts that clearly describe all material aspects of the outsourcing arrangement,

including the rights, responsibilities and expectations of all parties. When entering into or varying an outsourcing arrangement, the Board and Senior Management should consider, among other things:

- how the insurer's risk profile and business continuity will be affected by the outsourcing;
- the service provider's governance, risk management and internal controls and its ability to comply with applicable laws and with regulations;
- the service providers' service capability and financial viability; and
- succession issues to ensure a smooth transition when ending or varying an outsourcing arrangement.

8.8.6 In choosing an outsourcing provider, the Board or Senior Management should be required to satisfy themselves as to the expertise, knowledge and skills of such provider.

8.8.7 Outsourcing arrangements should be subject to periodic reviews. Periodic reports should be made to management and the Board.

ICP 9 Supervisory Review and Reporting [13]

The supervisor takes a risk-based approach to supervision that uses both off-site monitoring and on-site inspections to examine the business of each insurer, evaluate its condition, risk profile and conduct, the quality and effectiveness of its corporate governance and its compliance with relevant legislation and supervisory requirements. The supervisor obtains the necessary information to conduct effective supervision of insurers and evaluate the insurance market.

Introductory Guidance

9.0.1 This Insurance Core Principle and its standards and guidance deal with off-site monitoring and on-site inspections (collectively referred to as "supervisory review") and the reporting to the supervisor by the insurer as required for the supervisory process. It should be noted that certain aspects of supervisory review and reporting are dealt with in other ICPs with respect to those ICPs' specific areas of focus.

9.0.2 In applying this principle and these standards, it should be taken into account that, in some jurisdictions, responsibility is shared between more than one authority. Where this is the case, not all elements of the standards and guidance are necessarily applicable in full to each authority, although they apply in full to the jurisdiction as a whole. Relevant authorities within a jurisdiction should cooperate with each other in the application of this ICP to ensure an understanding of all risks that might be relevant to supervisory review and reporting. This is particularly important where prudential and conduct of business supervision is allocated to separate supervisors, taking into consideration that the intensity and focus of supervision may be different, even when within the same authority.[14]

9.0.3 This ICP and these standards apply to the supervision of insurers at the legal entity and the insurance group level, including branches.[15] In applying this ICP, its standards and guidance material, the supervisor takes into account the nature, scale and complexity of the insurer, and confidentiality requirements[16].

Supervisory powers

9.1 The supervisor has the necessary legal authority, powers and resources to perform off-site monitoring and conduct on-site inspections of insurers, including monitoring and inspecting services and activities outsourced by the insurer.[17] The supervisor also has the power to require insurers to submit information necessary for supervision.

[13] The ICP 9 Supervisory Review and Reporting was revised in 2011-2012 and adopted at the IAIS Annual General Meeting on 12 October 2012.
[14] Refer to paragraph 10 of the Introduction to the ICPs.
[15] Refer to paragraphs 13 – 15 of the Introduction to the ICPs.
[16] Refer to ICP 2 Supervisor and ICP 3 Information Exchange and Confidentiality Requirements.
[17] For information on the powers required of the supervisor in general, see ICP 1 Objectives, Powers and Responsibilities of the Supervisor and ICP 2 Supervisor.

9.1.1 The supervisor should ensure that adequate resources are allocated to supervisory review and reporting, to enable it to carry out a comprehensive assessment of the insurer, taking into account its nature, scale and complexity.

9.1.2 Services or activities that are outsourced by the insurer should be subject to the same level of supervisory review and reporting as the services or activities that are not outsourced and are performed by the insurer itself. The supervisor can do this through the insurer itself but should also have the ability to obtain information from, and conduct on-site inspections of, entities engaged in providing outsourced services or activities to the insurer, where necessary.

9.1.3 Agreements between the insurer and entities providing the outsourced activities or services should be drawn up in such a way that the supervisor's ability to conduct its supervisory activities is not restricted.

9.1.4 In those cases where the supervisor does not have direct supervisory powers over certain entities within the group – including non-regulated entities – the supervisor should have the power to apply an indirect approach, through the entities that it supervises in its jurisdiction, to achieve its supervisory objectives.[18]

Framework for supervisory review and reporting

9.2 The supervisor has a documented framework for supervisory review and reporting which takes into account the nature, scale and complexity of insurers. The framework encompasses a supervisory plan[19] that sets priorities and determines the appropriate depth and level of off-site monitoring and on-site inspection activity.

9.2.1 The supervisor should establish both qualitative and quantitative methods for assessing insurers, in a consistent manner and on an on-going basis. The supervisor should develop monitoring tools to identify potential risks within or affecting the insurer in a timely manner.

9.2.2 As an overall objective of the framework is to assess the insurer's current and prospective solvency, other risks and its treatment of customers, the supervisor should compare the risk profile of the insurer with its risk-carrying capacity and seek to detect any issues that may adversely affect the insurer's capacity to meet its obligations towards policyholders in the long term. The supervisor will also need to evaluate:

- the assets and liabilities (including off-balance sheet commitments);
- the technical operations (e.g. actuarial methods, underwriting policy, reinsurance policy);

[18] For additional information, see Guidance Paper on the Treatment of Non-regulated Entities in Group-wide Supervision, of 12 April 2010.

[19] A Supervisory Plan is a tool for supervisors to determine the frequency, scope and depth of supervisory review. It could be generic (e.g. addressing categories or groups of insurers) or specific (addressing individual insurers).

- the treatment of customers and whether any activities being engaged in are not fair, lawful or proper;
- the accounting and internal control systems;
- the insurer's compliance with supervisory requirements;
- the corporate culture and the effectiveness of the insurer's corporate governance and risk management; and
- the insurer's organisation and any implications of belonging to a group.

9.2.3 The framework should include an assessment of the potential impact that an insurer's failure would have on its policyholders, the insurance market, and the financial markets as a whole.

9.2.4 The framework should promote pro-active and early intervention by the supervisor, in order to enable the insurer to take appropriate action to mitigate risks and/or minimise current or future problems.

9.2.5 The supervisor should have documented procedures and/or guidelines to ensure that appropriate supervisory review procedures are being consistently and regularly performed. Such procedures should allow for the appropriate level or depth of review commensurate with the nature, scale and complexity of the insurer.

9.2.6 In order to evaluate existing and prospective risks, the supervisor should review the insurer's business plans and strategy. This review should include the insurer's approach to its legal and regulatory obligations, its distribution model and its proposals for dealing with specific areas of risk.

9.2.7 In establishing a supervisory plan the supervisor should assess and determine the key areas of risk to which insurers are exposed or risks which insurers may pose, using its judgement and the information, methodologies and tools at its disposal. The supervisory plan may include matters such as frequency, scope and depth of off-site monitoring and on-site inspections and priority and scope of assessments.

9.2.8 The framework uses the input from various sources, such as off-site monitoring and on-site inspections, market analyses, internal models, insurers' own risk and solvency assessments (ORSA)[20], horizontal reviews, previous risk and conduct assessments, and information gathered as a result of supervisory reporting requirements. The supervisor should use the information from these as input in establishing the scope and frequency of off-site monitoring and on-site inspections.

9.2.9 The supervisor should be able to process data in a timely and effective way. The supervisor should also have processes and procedures to collect and store reported data in an electronic format.

9.2.10 The framework should enable the supervisor to analyse trends and compare risk assessments including against any stress test outcomes. The supervisor should assess the quality of the outcomes of the insurer's enterprise risk management framework for the identification and

[20] Own Risk and Solvency Assessments, see ICP 8, Guidance 8.5.5 and ICP 16, Standards 16.11 to 16.16.

quantification of risks, and evaluate whether business lines or practices/processes show outcomes that support this assessment.

9.2.11 The framework should enable on-site inspection and off-site monitoring activities to be coordinated. Accordingly, the results of these activities should be documented and accessible to all involved staff within the supervisor.

9.2.12 The framework should include sufficiently comprehensive and regular communication between the supervisor and insurers to achieve the supervisory objectives. This communication involves senior levels and specialised areas within both the supervisor and insurers, and may include contact with non-regulated and parent entities.

9.2.13 The framework for supervisory review by the group-wide supervisor should cover all entities identified within the scope of the group, with reference to ICP 23 Group-wide Supervision. The framework should include appropriate tools for supervisory review and reporting for all relevant entities.

9.3 The supervisor has a mechanism to check periodically that its supervisory framework pays due attention to the evolving nature, scale and complexity of risks which may be posed by insurers and of risks to which insurers may be exposed.

9.3.1 The supervisory process is a dynamic one that takes a risk-based approach and includes:

- analysis of reported and other relevant information;
- developing and executing the supervisory plan;
- feedback;
- intervention, including any preventive/corrective action, where necessary; and
- follow-up (including setting the intensity of assessment and up-dating the supervisory plan).

9.3.2 Individual supervisory staff should confer regularly with colleagues to ensure that all relevant information is being appropriately assessed and analysed, and to facilitate the identification of potential new risks or emerging market trends.

9.3.3 The supervisory processes and plans should be suitably flexible to enable them to adapt easily to domestic and global developments in, for example, legislation, the financial markets, and international standards.

Supervisory reporting

9.4 The Supervisor:

- **establishes documented requirements for the submission of regular qualitative and quantitative information on a timely basis from all insurers licensed in its jurisdiction;**

- **defines the scope, content and frequency of those reports and information;**
- **requires more frequent and/or more detailed additional information on a timely basis whenever there is a need;**
- **sets out the relevant principles and norms for supervisory reporting, in particular the accounting standards to be used;**
- **requires that inaccurate reporting is corrected as soon as possible; and**
- **requires that an external audit opinion is provided on annual financial statements.**

9.4.1 The supervisor requires insurers to submit financial reports, which include at least a balance sheet and an income statement (including a statement of comprehensive income if appropriate) and reviews such information on a regular basis.

9.4.2 The supervisor requires and reviews qualitative information submitted by insurers, such as relating to their corporate governance framework.

9.4.3 The reporting requirements are a reflection of the supervisory needs and will thus vary according to overall market structure and conditions. The reporting requirements should take into account the situation at individual insurers and the way they manage their risks (for example, asset/liability management, reinsurance policy, quality of governance, policy for managing conflicts of interest, policy on complaints handling, training standards). In particular, the supervisor should require that information on changes that could materially impact the insurer's risk profile, financial position or treatment of its customers is obtained in a timely manner.

9.4.4 In setting the requirements, the supervisor should strike a balance between the need for information for supervisory purposes and the administrative burden it puts on insurers.

9.4.5 Reporting requirements should apply to all insurers licensed in a jurisdiction, and form the general basis for off-site monitoring. Depending on the nature, scale and complexity of the insurer and its customer profile, additional information may be requested from specific insurers on a case-by-case basis.

9.4.6 The supervisor may require that certain reports and information are subject to independent (internal or external) review, including audit and/or actuarial review.

9.4.7 In setting the reporting requirements, the supervisor may make a distinction between those for insurers incorporated in its jurisdiction and those for the branch operations in its jurisdiction of insurers incorporated in another jurisdiction.

9.4.8 The supervisor should require insurers to utilise a consistent and clear set of instructions and definitions for any element in the financial statements or other required reports that is not self-evident, in order to maximise comparability.

9.4.9 The supervisor should require an insurer which is part of an insurance group to describe its group reporting structure, and to provide timely notification of any material changes to that structure and significant

changes or incidents that could affect the soundness of the insurance group. The description of the reporting structure should include information on the relationships between entities within the group, and on the nature and volume of intra-group transactions. The supervisor may require information on the impact on the insurer of being part of a group.

9.4.10 The supervisor may request and obtain relevant information on any member of an insurance group, relating to its supervision of an insurer, subject to applicable legal provisions and coordination with the supervisors of affected jurisdictions.

9.4.11 The group-wide supervisor should establish supervisory reporting requirements on a group-wide basis in coordination with the host supervisors. The reporting may include the submission of information on group entities in other jurisdictions.

9.4.12 The information submitted to the group-wide supervisor should include information on the structure of the group, business operation and financial position of material entities within the group, relationship among entities within the group, including participation in other group entities and intra-group transactions with other entities within the group.

9.5 In particular, the supervisor requires insurers to report:

- **off-balance sheet exposures;**
- **material outsourced functions and activities; and**
- **any significant changes to their corporate governance.**

The supervisor also requires insurers to promptly report any material changes or incidents that could affect their condition or customers.

9.6 The supervisor periodically reviews its reporting requirements to ascertain that they still serve their intended objectives and to identify any gaps which need to be filled. The supervisor sets any additional requirements that it considers necessary for certain insurers based on their nature, scale and complexity.

Off-site monitoring

9.7 The supervisor monitors and supervises insurers on an on-going basis, based on regular communication with the insurer, information obtained through supervisory reporting and analysis of market and other relevant information.

9.7.1 The supervisor should be proactive and forward-looking in conducting effective off-site monitoring, and not rely only on historical data. The results will influence the supervisory plan and help determine the content, nature, timing and frequency of on-site inspections as well as enable the early detection of problems so that prompt corrective action can be taken before such problems become more serious.

9.7.2 The supervisor should analyse information received from insurers in a timely manner. Analysis by the supervisor may provide a deeper understanding of developing trends affecting an insurer and its customers, its risk tolerance and its strategy. Analysis by business lines may provide insights into the insurer's risk profile and business model and practices.

9.7.3 The supervisor should establish and follow written procedures for the analysis and monitoring of the supervisory reports that it receives. These may be conducted by individual supervisory staff using monitoring tools and/or specialised analysts/actuaries, as appropriate.

9.7.4 The supervisor should establish procedures for assessing the valuation of assets, liabilities and technical provisions including reviewing and analysing actuarial reports and audit reports (whether internal or external) and other reports as necessary, both quantitative and qualitative.[21]

9.7.5 Off-site monitoring should include a risk-based analysis on various risks relevant to the insurer such as credit, market, underwriting, reserving, liquidity, operational, conduct of business, legal, strategic and reputational risk.

9.7.6 Off-site monitoring should cover all material entities in a group, including non-regulated entities. Where the supervisor does not have direct supervisory power, or only limited power for the off-site monitoring of non-regulated entities, including a holding company, the supervisor should at a minimum review the potential adverse impact on the insurer of such non-regulated entities.

9.7.7 Further examples of how Standard 9.7 and the guidance under it can be pursued can be found in the Annex to this ICP.

On-site inspection

9.8 The supervisor sets the objective and scope for on-site inspections, develops corresponding work programmes and conducts such inspections.

9.8.1 On-site inspection may provide information that can supplement the analysis from off-site monitoring and the supervisor should take the opportunity to verify information it has received. On-site inspection may also help detect problems that may not be apparent through off-site monitoring.

9.8.2 On-site inspections should be tailored to the particular insurer and to any detected problems. However, an on-site inspection plan should remain flexible since new priorities might arise.

9.8.3 The supervisor may use on-site inspections as an opportunity to interact with the Board, Senior Management and Key Persons in Control Functions. This enables the supervisor to assess their on-going suitability, the insurer's organisational culture, the quality of their corporate governance, risk management and internal controls and to explore the rationale behind their strategy and business plan.

9.8.4 Important objectives in conducting an on-site inspection include reviewing the insurer's risk management processes and compliance with relevant insurance laws and regulations. This review helps the supervisor identify the strengths and weaknesses in the insurer's approach, and assess and analyse the risks to which an insurer and its customers are exposed.

[21] Refer to ICP 14 Valuation, ICP 15 Investment and ICP 17 Capital Adequacy.

9.8.5 The supervisor may delegate part of an on-site inspection to independent experts.[22] If it does so, the supervisor should:

- be satisfied that independent experts possess the necessary competence and skills;
- monitor their performance and retain the ability to take any necessary action against them;
- be satisfied of their independence from the insurer; and
- have regard to the consideration they give to the protection of the policyholders' interests.

9.8.6 The frequency, scope and depth of on-site inspections should take account of the insurer's distribution model, the nature, size and sophistication of its customer base and its relative importance in the market. On-site inspections should be more frequent and more in- depth when they concern insurers which are in a difficult financial position or where there is concern that their business practices pose a high risk of negative customer outcomes.

9.8.7 The supervisor may conduct on-site inspections on either a full scale basis, or limited scale basis focused on area(s) of specific concern. A full-scale on-site inspection would be expected to include at least the following:

- evaluation of the on-going effectiveness of the corporate governance structure including its risk management and internal control systems;[23]
- analysis of the nature of the insurer's key business activities (e.g. type of business written, customer base, distribution model(s) used);
- analysis of the relationships with external entities, such as through outsourcing or with respect to other companies in the same group, including any resultant conflicts of interest;
- analysis of the insurer's underwriting policy and reinsurance agreements;
- assessment of the insurer's financial strength; and
- assessment of the insurer's fair treatment of customers, including observance of conduct of business requirements and consumer regulations.

9.8.8 Advance notice to the insurer is not required before conducting an on-site inspection, although advance notice is normally given.

9.8.9 Although the supervisor may not have the power to conduct on-site inspections of non-regulated entities, including a holding company within the group, it should review, at a minimum, the potential adverse impact on the insurer of such non-regulated entities through on-site inspection of the insurer.

[22] Refer to Standard 2.13 for conditions for outsourcing supervisory functions to third parties.
[23] Refer to ICP 7 Corporate Governance and ICP 8 Risk Management and Internal Controls

9.8.10 Similarly, where the group-wide supervisor does not have the power to conduct on-site inspection of a group entity in another jurisdiction, it may approach the host supervisor to propose a joint inspection or recommend that the host supervisor undertake such an inspection, when deemed necessary.

9.8.11 Further examples of how Standard 9.8 and guidance under it can be pursued can be found in the Annex to this ICP.

Supervisory feedback and follow-up

9.9 The supervisor discusses with the insurer any relevant findings of the supervisory review and the need for any preventive or corrective action. The supervisor follows up to check that required actions have been taken by the insurer.

9.9.1 The supervisor should provide appropriate feedback to the insurer, at the conclusion of the review at the very least. The supervisor should issue in writing the findings of the review and the actions required.

9.9.2 The insurer's willingness to address identified issues and the action subsequently taken should be considered in the evaluation of the insurer and should be factored into the on-going supervisory plan.

Annex: Examples of ways in which Standards 9.7 and 9.8 and their corresponding guidance can be pursued include the following[24]:

A. The evaluation of the effectiveness of the corporate governance framework, including its risk management and internal control systems, can be done through:

- reviewing and analysing the minutes of the Board and its committees, the auditors' reports and, if any, actuaries' and electronic data processing audits;
- analysing the ownership structure and sources of capital funds;
- evaluating the independence of the Board Members, the suitability (fitness and propriety) of the Board Members, Senior Management and Key Persons in Control Functions, their effectiveness, and their ability to acknowledge improvement needs and correct mistakes (especially after such needs or mistakes have been identified by the insurer, its auditors, or the supervisor and after changes of management and in the Board);
- examining the insurer's internal policies, processes and controls in order to assess the adequacy of these in light of the insurer's risk profile;
- examining the accounting procedures in order to assess accuracy of the financial and statistical information periodically sent to the supervisor and its compliance with the regulations; and
- evaluating the organisation and the management of the insurer.

B. Analyses of the nature of the insurer's activities can be done through:

[24] Labelled Guidance 9.7.7 and 9.8.11 respectively in the ICP on-line tool

- analysing the major categories of business, the policyholders and the geographical spread thereof;
- analysing the distribution model(s) used;
- examining the business plans and meeting with the management to get information about the plans for the future;
- analysing material contracts;
- analysing the commercial policy of the insurer, in particular, policy conditions and commissions paid to the intermediaries; and
- evaluating the reinsurance cover and its security. In particular, the reinsurance cover should be appropriate with regards to the financial means of the insurer and the risks it covers.

C. Analyses of the relationships with external entities can be done through:

- analysing organisational charts, the group structures and the intragroup links;
- analysing the relationships with major investors and among branches and subsidiaries;
- analysing intragroup transactions, fees and other arrangements, including identifying any instances of cross-subsidization of businesses within a group or non-arm's length fees and charges;
- analysing agreements with external service providers;
- identifying any financial problems originating from any entity in the group to which the insurer belongs; and
- identifying of any conflicts of interest arising from intra-group relationships or relationships with external entities.

D. Evaluation of the insurer's financial strength can be done through:

- analysing the settlement of claims and the calculation of technical provisions according to current regulations;
- analysing the operations by line of business;
- analysing the investment policy (including derivatives policy), the assets held to cover the technical provisions;
- verifying property and valuation of the insurer’s investments;
- analysing the litigation and off-balance sheet commitments; and
- analysing the forecasted balance sheets and profit & loss accounts of the next years, on the basis of the most recent results and the management plans.

E. Assessment of the insurer's fair treatment of customers can be done through:

- assessing the culture of the insurer in relation to customer treatment, including the extent to which the insurer’s leadership, governance, performance management and recruitment, complaints handling policies and reward practices demonstrate a culture of fair treatment to customers;
- checking the adequacy, appropriateness and timeliness of the information given to consumers;

- reviewing the handling and timing of claims and other payments;
- reviewing the frequency and nature of customer complaints, disputes and litigation; and
- reviewing any customer satisfaction or other customer experience measures used by the insurer.

* * *

ICP 10 Preventive and Corrective Measures

The supervisor takes preventive and corrective measures that are timely, suitable and necessary to achieve the objectives of insurance supervision.

10.1 The supervisor has the power to take action against individuals or entities that conduct insurance activities without the necessary licence.

10.2 The supervisor has sufficient authority and ability, including the availability of adequate instruments, to take timely preventive and corrective measures if the insurer fails to operate in a manner that is consistent with sound business practices or regulatory requirements. There is a range of actions or remedial measures which include allowing for early intervention when necessary. Preventive and corrective measures are applied commensurate with the severity of the insurer's problems.

10.2.1 Where an insurer fails to meet regulatory requirements or enters into unsound business practices and the supervisor detects vulnerability in the insurer's ability to protect policyholders, there should be adequate legal and operational capacity available for timely intervention. The decision-making lines of the supervisor should be structured so that action can be taken immediately in the case of an emergency situation.

10.2.2 The supervisor has adequate tools to supervise insurers according to the nature, scale and complexity of their activities, including activities that could pose systemic risk. These could include restrictions on the insurer's business activities, directions to reinforce the insurer's financial position, introduction of liquidity requirements or large exposure limits.

10.3 There is a progressive escalation in actions or remedial measures that can be taken if the problems become worse or the insurer ignores requests from the supervisor to take preventive and corrective action.

10.4 If necessary, the supervisor requires the insurer to develop an acceptable plan for prevention and correction of problems. Preventive and corrective plans include agreed and acceptable steps to be taken to resolve the issues raised within an acceptable timeframe. Once preventive and corrective plans have been agreed to or imposed, the supervisor periodically checks to determine that the insurer is complying with the measures.

10.5 The supervisor communicates with the Board and Senior Management and Key Persons in Control Functions and brings to their attention any material concern in a timely manner to ensure that preventive and corrective measures are taken and the outstanding issues are followed through to a satisfactory resolution.

10.5.1 For a group-wide supervisor applying an indirect approach to group-wide supervision, the primary communication will be with the Board or Senior Management of the insurance legal entity. However, for issues that have arisen outside the regulated entities, communication with the Board or Senior Management of other entities within the group may be required.

10.6 The supervisor initiates measures designed to prevent a breach of the legislation from occurring, and promptly and effectively deals with non-compliance that could put policyholders at risk or impinge on any other supervisory objectives.

ICP 11 Enforcement

The supervisor enforces corrective action and, where needed, imposes sanctions based on clear and objective criteria that are publicly disclosed.

11.1 The supervisor has the power to enforce corrective action in a timely manner where problems involving insurers are identified. The supervisor issues formal directions to insurers to take particular actions or to desist from taking particular actions. The directions are appropriate to address the problems identified.

11.2 The supervisor has a range of actions available in order to apply appropriate enforcement where problems are encountered. Powers set out in legislation should at a minimum include restrictions on business activities and measures to reinforce the financial position of an insurer.

11.2.1 At a minimum, the supervisor should have the power to issue the following:

- restrictions on business activities
- prohibiting the insurer from issuing new policies
- withholding approval for new business activities or acquisitions
- restricting the transfer of assets
- restricting the ownership of subsidiaries
- restricting activities of a subsidiary where, in its opinion, such activities jeopardise the financial situation of the insurer.
- directions to reinforce financial position
- requiring measures that reduce or mitigate risks
- requiring an increase in capital
- restricting or suspending dividend or other payments to shareholders
- restricting purchase of the insurer's own shares.
- other directions
- arranging for the transfer of obligations under the policies from a failing insurer to another insurer that accepts this transfer
- suspending or revoking the licence of an insurer
- barring individuals acting in responsible capacities from such roles in future.

11.3 After corrective action has been taken or remedial measures, directions or sanctions have been imposed, the supervisor checks compliance by the insurer and assesses their effectiveness.

11.4 The supervisor has effective means to address management and governance problems, including the power to require the insurer to replace or restrict the

power of Board Members, Senior Management, Key Persons in Control Functions, significant owners and external auditors.

11.5 Where necessary and in extreme cases, the supervisor imposes conservatorship over an insurer that is failing to meet prudential or other requirements. The supervisor has the power to take control of the insurer, or to appoint other specified officials or receivers for the task, and to make other arrangements for the benefit of the policyholders.

11.6 There are sanctions by way of fines and other penalties against insurers and individuals where the provisions of the legislation are breached. The sanctions are proportionate to the identified breach.

11.6.1 In some cases it may be appropriate to apply punitive sanctions against insurers or individuals.

11.7 The legislation provides for sanctions against insurers and individuals who fail to provide information to the supervisor in a timely fashion, withhold information from the supervisor, provide information that is intended to mislead the supervisor or deliberately misreport to the supervisor.

11.8 The process of applying sanctions does not delay necessary preventive and corrective measures and enforcement.

11.9 The supervisor, or another responsible body in the jurisdiction, takes action to enforce all the sanctions that have been imposed.

11.10 The supervisor ensures consistency in the way insurers and individuals are sanctioned, so that similar violations and weaknesses attract similar sanctions.

ICP 12 Winding-up and Exit from the Market

The legislation defines a range of options for the exit of insurance legal entities from the market. It defines insolvency and establishes the criteria and procedure for dealing with insolvency of insurance legal entities. In the event of winding-up proceedings of insurance legal entities, the legal framework gives priority to the protection of policyholders and aims at minimising disruption to the timely provision of benefits to policyholders.

Introductory Guidance

12.0.1 This ICP only applies to individual legal entities. The focus of this ICP is on insolvency and run-off under distressed conditions; however policyholder protection also applies for financially sound run-offs.

12.0.2 An insurer may no longer be financially viable or may be insolvent. In such cases, the supervisor can be involved in resolutions that require a take-over by or merger with a healthier institution. When all other measures fail, the supervisor should have the ability to close or assist in the closure of the troubled insurer having regard to the objective of the protection of policyholder interests.

12.0.3 The legislation should establish the priority that policyholders receive in winding-up an insurer. However, it is also common in many jurisdictions that priority is given to other stakeholders, such as employees or the fiscal authorities. In some jurisdictions, a policyholder protection fund provides additional or alternative protection.

12.0.4 Where an insurer is a member of a group, there could be intra-group transactions and guarantees among the insurer and other group entities. In such cases, in the winding-up of an insurer, the supervisor should cooperate with other involved supervisors to ascertain orderly resolution where possible. For additional information on supervisory cooperation, see ICP 25 Supervisory Cooperation and Coordination.

12.0.5 In cases where an insurer has cross-border dealings (eg through branches), the supervisor should cooperate with other involved supervisors to ascertain orderly resolution where possible.

12.1 The procedures for the winding-up and exit of an insurer from the market are clearly set out in legislation. A high legal priority is given to the protection of the rights and entitlements of policyholders. The procedures aim at minimising the disruption to the timely provision of benefits to policyholders.

12.1.1 The bodies responsible for dealing with the insolvency of an insurer, including the possible restructuring or portfolio transfer, and winding-up of the insurer are clearly set out in legislation.

12.2 The legislation provides for the determination of the point at which it is no longer permissible for an insurer to continue its business.

ICP 13 Reinsurance and Other Forms of Risk Transfer[25]

The supervisor requires the insurer to manage effectively its use of reinsurance and other forms of risk transfer. The supervisor takes into account the nature of reinsurance business when supervising reinsurers based in its jurisdiction.

Introductory Guidance

13.0.1 Reinsurance refers to insurance purchased by an insurer (the ceding insurer) to provide protection against certain risks, primarily underwriting risks of the insurance policies issued by the insurer. Reinsurers assume these risks in exchange for a premium. Other forms of risk transfer include alternative reinsurance arrangements, such as risk transfer to the capital markets. For simplicity, this ICP uses "reinsurance" to refer to both mainstream reinsurance and other forms of risk transfer.

13.0.2 Geographical diversification of risk, which typically involves risk transfer across jurisdictional borders, is a key element of ceding insurer's and reinsurer´s capital and risk management. Geographical diversification can also have an impact in the jurisdiction of the ceding insurer, in particular jurisdictions exposed to catastrophes. By ceding insurance risk across borders, ceding insurers in the jurisdiction, and the jurisdiction as a whole, can benefit from a reduced concentration of insurance risk exposures at the ceding insurer and jurisdiction level respectively. This may also contribute to the financial stability of the jurisdiction.

13.0.3 Ceding insurers and reinsurers may face external limitations to geographical diversification, for example, in the form of constraints to cross-border risk transfer. The supervisor should be aware of and take into account the potential impacts of such limitations on individual ceding insurers and reinsurers as well as on the soundness and efficiency of the insurance market.

13.0.4 A reinsurance contract is one of indemnity between the reinsurer and ceding insurer and does not constitute a legal transfer of part of the underlying risk in the same way as, for example, a novation. Nonetheless, reinsurance contracts have the effect of transferring part of the underlying risk in an economic sense. The supervisor should remain aware that while reinsurance transfers insurance risk from the ceding insurer to the reinsurer, it also creates other risks. In a standard transaction, the ceding insurer reduces its insurance risk and assumes other risks such as credit, operational and basis risk; the reinsurer assumes risks such as insurance, timing, operational and credit risk.

13.0.5 A reinsurance contract is by nature a business-to-business transaction, made between professional counterparties as part of a wider risk and capital management approach. For this reason, the sort of asymmetry of expertise and knowledge associated with insurance contracts involving general consumers is usually not an issue in the reinsurance sector, although some asymmetry of bargaining power can exist, depending on

[25] Amended November 2017

the precise dynamics of the market. Thus, typically, it is not necessary for the supervisor to seek the same level of protection for ceding insurers as it does for general consumers (see ICP 19 Conduct of Business).

13.0.6 The supervisor should be able to assess whether ceding insurers make effective use of reinsurance. This involves gaining an understanding of, and comfort with, at a minimum:

- the ceding insurer's reinsurance strategy and reinsurance programme;
- the systems of risk management and internal controls put in place in order to implement the reinsurance strategy and execute the reinsurance programme;
- the economic impact of the risk transfer originating from the ceding insurer's reinsurance programme; and
- the impact of reinsurance on the ceding insurer's liquidity management.

13.0.7 The standards and guidance under this ICP are applicable to insurers and reinsurers, thus throughout this ICP:

- references to ceded reinsurance should be taken to include ceded retrocession (i.e. the reinsurance ceded by reinsurers);
- references to ceding insurers should be taken to include ceding reinsurers (i.e. retrocedants); and
- references to reinsurers should be taken to include retrocessionaires (i.e. reinsurers that assume reinsurance from ceding reinsurers).

13.1 The supervisor requires ceding insurers to have a reinsurance programme that is appropriate to their business and part of their overall risk and capital management strategies.

13.1.1 A ceding insurer's risk and capital management strategies should clearly articulate the part played by reinsurance, in particular:

- the objectives that are pursued by using reinsurance;
- the risk concentration levels and ceding limits as defined by the ceding insurer's risk appetite; and
- the mechanisms to manage and control reinsurance risks.

13.1.2 When articulating the part played by reinsurance in the overall risk and capital management strategies, the ceding insurer should take into account its business objectives, levels of capital and business mix, with particular reference to:

- risk appetite (both gross limit and net retention);
- peak exposures and seasonality in the insurance book;
- levels of diversification in the insurance book; and
- appetite for credit risk posed by reinsurers.

13.1.3 The reinsurance programme comprises the detailed implementation of the reinsurance related elements of the risk and capital management strategies in terms of coverage, limits, deductibles, layers, signed lines and markets used. It should reflect the ceding insurer's overall risk appetite, comparative costs of capital and liquidity positions determined in the reinsurance strategy. Therefore, reinsurance programmes can vary significantly in complexity, levels of exposure and number of participants.

13.1.4 In some instances, an insurer may have a business strategy and risk appetite to retain all risk and therefore a reinsurance programme would not be necessary.

13.1.5 Senior Management develops the reinsurance related elements of the risk management strategy as well as the reinsurance programme. Senior Management is also responsible for establishing appropriate systems and controls to ensure that these are complied with. The Board is responsible for approving the strategy and ensuring an appropriate oversight and consistent implementation of the reinsurance programme.

13.1.6 Senior Management of the ceding insurer should regularly review the performance of its reinsurance programme, to ensure that it functions as intended and continues to meet its strategic objectives. It is likely that such a review would take place as part of the feedback loop that is part of the risk management framework.

13.1.7 The supervisor should understand the ceding insurer's business objectives and strategies, how reinsurance fits into these, and assess the extent to which objectives and strategies are adequately reflected in the reinsurance programme. The supervisor should challenge the ceding insurer where it identifies inconsistencies between the objectives and strategies and the reinsurance programme.

13.1.8 The supervisor's assessment of a ceding insurer's reinsurance programme should be based on a number of factors, such as the:

- structure of the programme, including any alternative risk transfer mechanisms;
- proportion of business ceded so that the net risks retained are commensurate with the ceding insurer's financial resources and risk appetite;
- financial strength and claims payment record of the reinsurers in question (both in normal and stressed conditions);
- levels of exposure to a single reinsurer or different reinsurers being part of the same group;
- extent of any credit risk mitigation in place;
- expected resilience of the reinsurance programme in stressed claims situations, including stress related to the occurrence of multiple and/or catastrophic events;
- cession limits, if any, applicable in the jurisdiction;
- the supervisory regime in place in the jurisdiction of the reinsurer;

- level of effective risk transfer; and
- extent to which relevant functions are outsourced by the ceding insurer, including the criteria for the selection of reinsurance brokers.

Group perspectives

13.1.9 The group-wide supervisor should require a reinsurance strategy for the insurance group that includes the following issues:

- its interaction with the group-wide risk and capital management strategies;
- how the risk appetite is achieved, on both a gross limit and net retention basis;
- the appetite for reinsurer credit risk, including approved security criteria for reinsurance transactions and aggregate exposure criteria to individual or related reinsurers;
- the autonomy afforded to individual insurance legal entities to enter into "entity specific" reinsurance arrangements, and the management and the aggregation of these exposures in the group-wide context;
- procedures for managing reinsurance recoverables, including required reporting from insurers;
- intra-group reinsurance strategy and practice; and
- use of alternative risk transfer, including capital markets risk transfer products.

13.2 **The supervisor requires ceding insurers to establish effective internal controls over the implementation of their reinsurance programme.**

13.2.1 Control of the reinsurance programme should be part of the ceding insurer's overall system of risk management and internal controls (see ICP 8 Risk Management and Internal Controls). The supervisor should require that the controls and oversight in place are suitable in the context of the ceding insurer's business.

13.2.2 The ceding insurer should ensure that the characteristics of its reinsurance programme, including the credit risk posed by the reinsurer, are reflected in its capital adequacy assessment as well as its ORSA (See ICP 16 Enterprise Risk Management for Solvency Purposes).

Credit risk posed by the reinsurer

13.2.3 When developing the reinsurance programme the ceding insurer should consider its appetite for reinsurer credit risk. Reinsurers may face solvency issues, leading to delayed payment or default, and this can have significant consequences for the solvency and liquidity of the ceding insurer.

13.2.4 In practice, ceding insurers have various options to mitigate reinsurer credit risk, for example:

- establishing criteria on the financial strength and claims payment record of eligible reinsurers;
- setting limits on risks ceded to a single reinsurer;
- ensuring a spread of risk amongst a number of reinsurers;
- incorporating rating downgrade or other special termination clauses into the reinsurance contract;
- requiring the reinsurer to post collateral (the ability to require this may depend upon the relative commercial strengths of the ceding insurer and reinsurer);
- proactively monitoring reinsurance claims recoveries; and
- withholding reinsurer's funds.

Approved security criteria

13.2.5 The ceding insurer should have in place procedures for identifying reinsurers that meet its security requirements. If a ceding insurer develops a pre-approved list of reinsurers, there should also be processes for dealing with situations where there is a need to assess reinsurers outside any pre-approved list. Ceding insurers may have their own credit committees to make their own assessment of the risk.

13.2.6 In line with other approaches to identifying appropriate reinsurers, any approved security criteria should be derived from a high level statement of what reinsurance security will be acceptable to the ceding insurer, which may be based on:

- external opinions;
- the ceding insurer's own view of the reinsurer;
- minimum levels of capital;
- duration and quality of relationship;
- expertise of the reinsurer;
- levels of retrocession;
- reinsurance brokers' security criteria; or
- a mixture of these and other factors.

Aggregate exposure limits or guidelines

13.2.7 A ceding insurer should set prudent limits or guidelines reflecting security and size of the reinsurer, in relation to its maximum aggregate exposure to any one reinsurer or to a group of related reinsurers, which would be complementary to any supervisory limits or guidelines.

13.2.8 The ceding insurer should have in place procedures for monitoring this aggregate exposure to ensure that these limits or guidelines are not breached. The ceding insurer should also have procedures to manage excess concentrations going forward, such as bringing them back within limits or guidelines.

Matching of underlying underwriting criteria

13.2.9 The ceding insurer should give due consideration to the risk posed by a mismatch in terms and conditions between reinsurance contracts and the underlying policies. The ceding insurer may bear a greater net exposure than it initially intended because of this gap.

Criteria and procedures for purchasing facultative cover

13.2.10 The ceding insurer should have appropriate criteria in place for the purchase of facultative coverage. Any facultative reinsurance coverage bought should be linked to the procedures for aggregations and recovery management.

13.2.11 The ceding insurer should have a specific process in place to approve, monitor and confirm the placement of each facultative risk. If facultative reinsurance is necessary to ensure that acceptance of a risk would not exceed maximum net capacity and/or risk limits, such reinsurance should be secured before the ceding insurer accepts the risk.

Operational risk related to contract documentation

13.2.12 In order to reduce the risk and scope of future disputes, the ceding insurer and the reinsurer should have in place processes and adequate controls to document the principal economic and coverage terms and conditions of reinsurance contracts clearly and promptly.

13.2.13 Ceding insurers and reinsurers should finalise the formal reinsurance contract without undue delay, ideally prior to the inception date of the reinsurance contract.

13.2.14 All material reporting due to and from reinsurers should be timely and complete, and settlements should be made as required by the reinsurance contract.

13.2.15 The ceding insurer should consider how its reinsurance contracts will operate in the event of an insolvency of itself or its reinsurer.

13.2.16 The supervisor should have access, on request, to material reinsurance documentation. In case of indications of significant uncertainties in terms of reinsurance documentation, the supervisor should take into account the resulting underwriting, operational and legal risks when considering the effects of reinsurance on the ceding insurer's solvency.

13.3 The supervisor requires ceding insurers to demonstrate the economic impact of the risk transfer originating from their reinsurance contracts.

13.3.1 The supervisor should regard as a reinsurance contract an agreement that transfers sufficient insurance risk to be considered insurance under jurisdictional rules.

13.3.2 In general, a contract should be considered as a loan or deposit if, during its development, the ceding insurer has the unconditional obligation to indemnify the reinsurer for any negative balances that may arise out of the contractual relationship. This characteristic does not result in risk transfer. All liabilities of the ceding insurer should be contingent on the proceeds of the underlying insurance business.

13.3.3 Upon request from the supervisor, the ceding insurer should provide sufficient information about its reinsurance contracts to allow the supervisor to make informed judgments about the substance of the risk transfer (i.e., the degree of risk transfer in an economic sense).

13.3.4 Where there are concerns of inappropriate reporting with respect to the degree of risk transfer, the supervisor should assess the substance of the reinsurance contract entered into by the ceding insurer and how it has been reported by the ceding insurer. Further, the supervisor should be able to assess the impact that the ceding insurer's reinsurance contracts have on the ceding insurer's capital requirements. The supervisor should challenge Senior Management of the ceding insurer on the purpose of individual contracts where appropriate.

Finite reinsurance

13.3.5 Finite reinsurance is a generic term that, for the purposes of this ICP, is used to describe a spectrum of reinsurance arrangements that transfer limited risk relative to aggregate premiums that could be charged under the contract.

13.3.6 Finite reinsurance transactions are legitimate forms of reinsurance arrangements; however, it is essential that they are accounted for appropriately. In particular, only contracts that transfer sufficient insurance risk in order to meet the requirements of the relevant accounting standards in force in each jurisdiction can be accounted for as reinsurance.

13.3.7 The supervisor should pay particular attention to reinsurance contracts that have, or appear to have, limited levels of risk transfer which may change over the duration of the contract. Only the amount of risk transferred under finite reinsurance contracts should be included in the regulatory capital calculations of the ceding insurer.

13.4 **When supervising ceding insurers purchasing reinsurance across borders, the supervisor takes into account the supervision performed in the jurisdiction of the reinsurer.**

13.4.1 The cross-border nature of reinsurance transactions, together with the relative sophistication of the market participants involved in reinsurance, are key elements that the supervisor should consider when supervising ceding insurers.

13.4.2 Taking into account the supervision performed in the jurisdiction of the reinsurer may help the supervisor to assess the overall risk profile of the ceding insurer. This can be done, for example, by reviewing the supervisory framework and practices in the jurisdiction of the reinsurer, or by engaging in supervisor-to-supervisor dialogue.

Supervisory recognition

13.4.3 The supervisor can benefit from relying on supervision performed in the jurisdiction of the reinsurer. Benefits may include, for example, strengthened supervision as well as a more efficient use of resources by the supervisor of the ceding insurer.

13.4.4 Where supervisors choose to recognise aspects of the work of other supervisory authorities, they should consider putting a formal supervisory

recognition arrangement in place (see ICP 3 Information Exchange and Confidentiality Requirements).

13.4.5 Supervisory recognition can be conducted through unilateral, bilateral and multilateral approaches to recognition. All three approaches recognise the extent of equivalence, compatibility or, at least, acceptability of a counterparty's supervisory system. Bilateral and multilateral approaches typically incorporate a mutuality component to the recognition element, indicating that this is reciprocal.

13.5 The supervisor requires the ceding insurer to consider the impact of its reinsurance programme in its liquidity management.

13.5.1 Given the nature and direction of cash flows within a ceding insurer, liquidity risk historically has not been considered to be a major issue in the insurance sector. However, there can be liquidity issues within an individual ceding insurer which could arise specifically from the ceding insurer's reinsurance programme.

13.5.2 Reinsurance contracts do not remove the ceding insurer's underlying legal liability to its policyholders. The ceding insurer remains liable to fund all valid claims under contracts of insurance it has written, regardless of whether they are reinsured or not. For this reason, a large claim or series of claims could give rise to cash flow difficulties if there are delays in collecting from reinsurers or in the ceding insurer providing proof of loss to reinsurers.

13.5.3 The supervisor should require ceding insurers to take appropriate measures to manage their liquidity risk, including funding requirements in adverse circumstances. As with all risks, the insurer should develop its own response to the level of risk it faces and the supervisor should assess these responses. There are a number of ways in which liquidity risk may be mitigated. For example, some insurers choose to arrange a line of credit from a bank in order to deal with short-term liquidity issues.

13.5.4 Ceding insurers may make arrangements with their reinsurers in order to mitigate their liquidity risk. These arrangements, if used, may include clauses that trigger accelerated payment of amounts due from reinsurers in the event of a large claim and/or the use of collateral or deposit accounts, giving ceding insurers access to funds as needed. Use of such arrangements is a commercial matter between the ceding insurer and reinsurer.

13.5.5 External triggers can give rise to liquidity issues, especially where reinsurers have retroceded significant amounts of business. If a reinsurance contract contains a downgrade clause that gives the ceding insurer the right to alter the contract provisions, or obliges the reinsurer to post collateral with a ceding insurer to cover some or all of its obligations to that ceding insurer, such action may cause liquidity issues among reinsurers and may be pro-cyclical. Therefore, the supervisor should be aware of the potential consequences of such triggers for the overall efficiency and stability of the market.

13.6 In jurisdictions that permit risk transfer to the capital markets, the supervisor understands and assesses the structure and operation of such risk transfer arrangements, and addresses any issues that may arise.

13.6.1 A wide range of techniques has been developed to allow the transfer of insurance risk to the capital markets, resulting in a diversity and complexity of risk transfer arrangements.

13.6.2 In general, arrangements used to enable risk transfer to the capital markets operate like mainstream reinsurance. For example, risk is transferred via a reinsurance contract with similar terms and conditions to any other reinsurance contract. Further, the risk assuming entity is a reinsurer subjected to licensing conditions like any other reinsurer. The defining feature of these risk transfer arrangements is the direct funding of the reinsurance risk exposure with funds raised, often exclusively, in the capital markets.

13.6.3 Insurance risk transfer to the capital markets can occur by making use of a wide variety of arrangements. Arrangements in the non-life sector are often broadly classified into four groups: 1) catastrophe bonds (cat bonds); 2) collateralised reinsurance; 3) industry loss warranties (ILWs); and 4) sidecars. These four groups, which are not mutually exclusive, focus on different elements of the risk transfer arrangements:

- cat bonds take the name from the financial instrument (i.e. a debt security) issued to fund an insurance exposure, usually a catastrophe;
- collateralised reinsurance is generally used to highlight a credit risk mitigation feature of certain insurance transactions (i.e. the collateralisation of the insurance exposure);
- ILWs refer to a range of financial instruments used by counterparties, who may or may not be insurers, to buy or sell protection related to insurance risks; and
- sidecars refer to a legal entity created 'on the side' of an insurer that is used to transfer insurance risk, usually to the capital markets.

To illustrate that these are not mutually exclusive, there could be a sidecar that underwrites insurance risk via an ILW and funds the exposure through an issuance of cat bonds, the proceeds of which are used to collateralise the reinsurance risk assumed.

13.6.4 In the life sector, some arrangements are similar to the non-life sector (for example, mortality bonds, which operate like cat bonds). Other life insurance arrangements have specific features that are not used in non-life insurance, such as the funding of certain portions of the ceding insurer's reserves.

13.6.5 Despite the many similarities with mainstream insurance, transactions transferring insurance risk to the capital markets have special features that the supervisor should bear in mind in order to assess the appropriateness and effectiveness of their use by ceding insurers and reinsurers.

Initial assessment

13.6.6 Insurance risk transfer to the capital markets usually entails the creation of a dedicated entity or a legally ring-fenced arrangement, specifically constituted to carry out the transfer of risk. These are referred to by a variety of names, such as special purpose vehicles, special purpose

reinsurance vehicles, or special purpose insurers; for the purpose of this ICP, they are collectively referred to as special purpose entities (SPEs).

13.6.7 The main purpose of an SPE is to assume insurance risk, funding the exposure by raising funds in the capital markets, and to be dismantled once its purpose has been fulfilled. Importantly, as SPEs conduct insurance business, the supervisor should consider licensing them as insurers (see ICP 4 Licensing). Licensing of SPEs should be appropriately tailored to take into consideration the unique characteristics of SPEs. In this respect, close collaboration among those supervising ceding insurers and those supervising SPEs before authorisation of the SPE and on an on-going basis can be particularly helpful.

13.6.8 Key elements of any SPE structure include:

- the insurance risk that it assumes is "fully funded" (i.e., that the exposure taken by the SPE is funded across a range of foreseeable scenarios from the time the SPE goes on risk to the time it comes off risk);
- the claims of any investors in the SPE are subordinate to those of the ceding insurer; and
- the investors in the SPE have no recourse to the ceding insurer in the event of an economic loss.

13.6.9 In order to be able to understand and assess whether an SPE structure meets the criteria above, the supervisor should take the following into account:

- ownership structure of the SPE;
- suitability of the Board and Senior Management of the SPE;
- the SPE's management of credit, market, underwriting and operational risks;
- investment and liquidity strategy of the SPE;ranking and priority of payments;
- extent to which the cash flows in the SPE structure have been stress tested;
- arrangements for holding the SPE's assets (e.g. trust accounts) and the legal ownership of the assets;
- extent to which the SPE's assets are diversified; and
- use of derivatives, especially for purposes other than risk reduction and efficient portfolio management.

13.6.10 Understanding the role of all the parties to the SPE arrangement is critical to understanding the underlying risks, particularly as these may be fundamentally different from those involved in a traditional reinsurance transaction. The supervisor should understand and assess, among other things, the:

- extent to which key parties have been fully disclosed (e.g. sponsor, (re)insured, investors, advisors, counterparties) and are known to the supervisor;

- extent to which potential conflicts of interest between all parties to the SPE have been adequately disclosed and addressed (such as situations where sponsors also take a managing role);
- credit risk associated with key service providers, including financial guarantors used to protect the position of investors;
- degree of basis risk that is assumed by the ceding insurer and to what extent this could have immediate ramifications for the ceding insurer's financial position in case of a loss;
- details of the SPE's management arrangements and key personnel;
- third party assessments of the SPE structure (e.g. by credit rating agencies);
- expertise of the legal advisors involved;
- robustness of any financial or actuarial projections, if applicable (e.g. if triggers are indemnity based); and
- disclosure of outsourcing agreements.

13.6.11 As many SPEs are designed to operate with a minimum of day-to-day management, the supervisor should understand and assess the extent to which the systems of risk management and internal controls are adequate and proportionate to the nature of the underlying risks and to the complexity and expected lifespan of the SPE structure.

13.6.12 The systems of risk management and internal controls of the SPE should ensure that, at a minimum:

- investment restrictions are not breached;
- interest payments, dividends, expenses and taxes are properly accounted for;
- movements above established thresholds in assets and collateral accounts are reported;
- assets are legally existent and technically identifiable; and
- liabilities can be determined on a timely and accurate basis and obligations satisfied in accordance with the underlying contracts.

13.6.13 The supervisor should understand and assess:

- the systems of risk management and internal controls of the SPE, particularly the extent to which these are sufficient to ensure effective operation in compliance with the SPE's legal and supervisory obligations; and
- operational risks within the SPE structure and any mitigation arrangements.

Basis risk

13.6.14 The supervisor should understand and assess the extent to which SPE arrangements give rise to basis risk. This arises where the trigger for

indemnity under the SPE arrangement is different from the basis on which underlying protected liabilities can arise.

13.6.15 Where SPEs contain indemnity triggers (i.e., recovery from the SPE is based on the actual loss experience of the ceding insurer) basis risk is unlikely to be an issue. However, many SPEs contain non-indemnity triggers, such as parametric triggers (driven by objectively measurable events) or modelled triggers (driven by the outcome of modelled, industry-wide losses). In such cases, there may be events where the ceding insurer will remain exposed to its underlying policyholders without having recourse to the SPE.

13.6.16 Basis risk should be considered with reference either to the amount of credit given by the supervisor of the ceding insurer for the SPE arrangement or in the capital requirement of the ceding insurer, where such mechanisms are used.

13.6.17 Additionally, in some jurisdictions the accounting and regulatory treatment of insurance risk transfer that uses non-indemnity triggers may be different from the accounting treatment of indemnity-based insurance. The supervisor should understand these accounting differences and the impact these may have on the financial statements of the ceding insurer and the reinsurer.

Ongoing Supervision

13.6.18 The supervisor should understand the various issues that emerge in the ongoing supervision of SPEs and their use. Consideration should be given to the following areas:

- measures to be taken by the supervisor if any of the licensing or authorisation conditions are breached;
- level of capital and ability of the SPE to continue to respond adequately should covered events occur;
- level of reporting required by the supervisor in order to understand and assess whether the SPE is complying with its obligations;
- the SPE's response in the event of fluctuations in the values of invested assets (e.g. match/mismatch between collateral account and exposure, flow of premiums, fees, commissions);
- arrangements put in place in the SPE to ensure that the "fully funded" condition is maintained in the case that the insurance risks assumed are rolled over from one risk period to another; and
- where the SPE undertakes multiple transactions, arrangements put in place in the SPE to ensure that the funds corresponding to each transaction are appropriately segregated and legally insulated.

Unwinding of SPE arrangements

13.6.19 The unwinding of SPEs is often influenced by the dynamics of insurance losses. The supervisor should understand and gain comfort with the provisions in place to require orderly unwinding of SPEs. In particular, the supervisor should understand the process related to the generation, mitigation and management of any residual risk emerging from the unwinding of the SPE.

13.6.20 In addition, the supervisor should understand the process and stages that the SPE goes through when it comes to a natural end and its obligations have been fulfilled and the SPE is liquidated. There is a distinction between unwinding in the event of a loss and unwinding a transaction reaching legal maturity (without a loss having occurred). While the latter case is usually simple and straightforward, unwinding in a full or partial loss situation deserves close attention. Consideration should be given to the following areas:

- issues relating to share buy-back and conditions to its materialisation;
- issues relating to disposal of the investment portfolio;
- "dismantling" of the SPE and residual risks;
- where the SPE undertakes multiple transactions, issues relating to the segregation and legal insulation of assets per transaction; and
- supervisory issues relating to risks which revert to the ceding insurer on termination of the arrangement.

Considerations for supervisors of insurers ceding risks to SPEs

13.6.21 Although in many jurisdictions insurance risk transfer to the capital markets is not permitted, the supervisor should consider that some of the insurers in its jurisdiction may be transferring insurance risk to SPEs located in another jurisdiction that permits insurance risk transfer to the capital markets. In this case, the supervisor of the ceding insurer should consider, among other things:

- whether the risk transfer taking place involves an SPE that is licensed in the jurisdiction where the insurance risk is assumed;
- the supervisory regime to which the SPE is subject in its jurisdiction; and
- the extent to which the ceding insurer has adequately provided for the identification, assessment and management of the risks associated with transferring insurance risk to an SPE (e.g. credit risk, basis risk).

ICP 14 Valuation

The supervisor establishes requirements for the valuation of assets and liabilities for solvency purposes.

Introductory Guidance

Application

14.0.1 The IAIS considers it is most desirable that the methodologies for calculating items in general purpose financial reports can be used for, or are substantially consistent with, the methodologies used for regulatory reporting purposes, with as few changes as possible to satisfy regulatory requirements. However, the IAIS also recognises that this may not be possible or appropriate in all respects, considering the differing purposes. The IAIS believes it is essential that differences between general purpose financial reports and published regulatory reports are publicly explained and reconciled.

14.0.2 The IAIS considers that differences between technical provisions for general purpose financial reports and published regulatory reports should be publicly explained and reconciled in terms of differences in data, discount rate, methodology and assumptions used together with the rationale for why any different approach is appropriate for solvency purposes.

14.0.3 To the extent that financial reporting standards, including IFRS, are consistent with the standards in this ICP, valuations that are in accordance with those financial reporting standards may be regarded as compliant with this ICP.

14.0.4 The context and purpose of the valuation of assets or liabilities of an insurer are key factors in determining the values that should be placed on them. This ICP considers the valuation requirements that should be met for the purpose of the solvency assessment of insurers within the context of IAIS risk-based solvency requirements that reflect a total balance sheet approach on an economic basis[26] and address all reasonably foreseeable and relevant risks.

14.0.5 Standard 17.1 states that the supervisor requires a total balance sheet approach to be used in the assessment of solvency to recognise the interdependence between assets, liabilities, regulatory capital requirements and capital resources and to require that risks are appropriately recognised[27]. Such an approach ensures that the determination of available and required capital is based on consistent assumptions for the recognition and valuation of assets and liabilities for solvency purposes.

[26] An economic basis may include amortised cost valuations and market-consistent valuations that comply with this ICP.

[27] The total balance sheet approach is an overall concept rather than one which implies the use of a particular methodology such as a cost of capital method or a percentile method.

14.0.6 To achieve consistency with this approach to setting capital requirements in the context of a total balance sheet approach, capital resources should broadly be regarded as the difference between assets and liabilities, but on the basis of their recognition and valuation for solvency purposes.

Solvency purposes

14.0.7 The valuation "for solvency purposes" referred to in this ICP is the valuation of the assets and liabilities used within the broad concept of a risk-based solvency assessment of insurers.

14.0.8 Solvency assessment results from the application of supervisory judgment to various measures and estimates of an insurer's current financial position and future financial condition which serve to demonstrate the insurer's ability to meet its policyholder obligations when they fall due. Useful in this regard is a set of financial statements which may differ from those used for general purpose financial reporting. To distinguish them, this ICP refers to the financial statements used for solvency assessment as "regulatory financial statements". Such statements include a regulatory balance sheet and regulatory capital requirements. For the purposes of this ICP, "valuation for solvency purposes" refers to valuation of assets and liabilities in the regulatory financial statements. The overall solvency assessment may use information additional to the regulatory financial statements such as:

- stress and scenario testing;
- the insurer's own risk and solvency assessment; and
- relevant disclosure.

14.0.9 Technical provisions are a significant component of valuation for solvency purposes. They include a margin for risk appropriate for solvency purposes. Regulatory capital requirements are another component of the solvency assessment, and they include further allowance for risk so that when taken together, they are sufficient to ensure that policy obligations are satisfied with the probability of sufficiency required by the supervisor.

14.0.10 In adverse circumstances, certain assets may be considered to have reduced or nil value. Consequently, in the capital adequacy assessment such assets may be excluded from or have reduced value in capital resources. Alternatively, a capital requirement may be set to cover the potential shortfall in value. Such adjustments are part of the process of determining capital requirements and/or capital resources and are covered by ICP 17 Capital Adequacy. These adjustments are shown separately from asset values in the regulatory financial statements. This enables improved transparency, consistency and comparability.

14.1 The valuation addresses recognition, derecognition and measurement of assets and liabilities.

14.1.1 Assets and liabilities should be recognised and derecognised to the extent necessary for risks to be appropriately recognised. Such recognition/derecognition principles may differ from those used for general purpose financial reporting in a jurisdiction.

14.1.2 Recognition of insurance contracts as part of the valuation of technical provisions is a significant issue for insurers and supervisors. There are two key possible points of recognition – on entering into a binding contract (the bound date) and the inception date of the contract. In principle, the bound date is the date at which an economic obligation arises. However, in practice, these dates are only likely to be significantly different for certain classes of non-life insurance.

14.1.3 Contracts for ceded reinsurance should be recognised and valued so as to correspond to the recognition of the risks which they are mitigating. Where a current reinsurance policy is contracted to cover future direct policies, the value of the reinsurance policy should not include any amount in respect of future direct policies that have not been recognised.

14.1.4 An insurance contract liability (or a part of an insurance contract liability) within technical provisions should be derecognised when, and only when, it is extinguished – i.e. when the obligation specified in the insurance contract is discharged or cancelled or expires.

14.1.5 The purchase of reinsurance should not result in the derecognition of technical provisions unless the purchase of that reinsurance results effectively in the extinguishment or novation of the insurance contracts.

14.2 The valuation of assets and liabilities is undertaken on consistent bases.

14.2.1 Solvency assessment based on consistent valuation of assets and liabilities is a prerequisite for obtaining a meaningful insight into the asset-liability positions of an insurer and an understanding of the financial position of an insurer relative to other insurers. It provides reliable information on which to base the actions that are taken by insurers and their supervisors in respect of those positions.

14.2.2 The overall financial position of an insurer should be based on the consistent measurement of assets and liabilities, the explicit identification and consistent measurement of risks and their potential impact on all components of the balance sheet. This consistency should apply to all assets and liabilities, including assets in excess of the liabilities, and extend across insurers and time periods so as to achieve comparability.

14.2.3 Undertaking valuation on consistent bases means that differences in values of assets and liabilities can be explained in terms of the differences in the nature of the cash flows including their timing, amount and inherent uncertainty, rather than differences in methodology or assumptions. Such consistency may be applied at different levels such as segment within a company, a company or a group.

14.2.4 Observed market valuations or amortised cost valuations may be used for some assets and liabilities, while valuation models, such as discounted cash flow models, may be used for other assets and liabilities. Calibration of such discounted cash flow models to market valuations or amortised cost of other assets and liabilities can be of assistance in achieving consistency.

14.2.5 The specific characteristics of insurance contracts, financial instruments and data available may vary within and across jurisdictions. Consistency in the valuation of assets and liabilities means that such variations can be

explained in terms of the differences in the nature of the cash flows valued in each jurisdiction.

14.2.6 Regulatory capital requirements are determined using a consistent treatment of the valuation of assets and liabilities. Consistency in the valuation of assets and liabilities for solvency purposes does not necessarily mean that a single valuation basis is used for all assets and liabilities. The balance sheet, when taken together with capital requirements, should result in an appropriate recognition of risks.

14.3 The valuation of assets and liabilities is undertaken in a reliable, decision useful and transparent manner.

Reliability

14.3.1 The values placed on the assets and liabilities of an insurer for solvency purposes should be a reliable measure of their value at the date of solvency assessment.

14.3.2 Objectivity is an important aspect of valuing assets and liabilities in a reliable manner, so that a valuation is not influenced inappropriately by an insurer's management. The valuation of assets and liabilities typically involves judgment, e.g. expert judgment in assessing the relevance of data and deriving assumptions. Consistent with reliability of outcome, subjectivity in valuation should be reduced as far as practicable. This may be achieved by using information available from effective internal control processes, market valuations and other relevant current or factual information, by applying professional standards and subjecting valuations to independent review. The supervisor should require a valuation methodology which uses information provided by the financial markets and generally available data on insurance technical risks. Company-specific information may be appropriate, for example, where the insurer's business model and practices are sufficiently substantiated as representative of the portfolio and similar information is used in market valuations.

Decision usefulness

14.3.3 In the context of this standard, 'decision useful' means useful in making judgments for solvency purposes. It should be recognised that, in valuing assets and liabilities in a reliable manner, and in reducing the subjectivity in the valuation, it may not be appropriate to eliminate subjectivity completely. A method that provides a single value without the need for judgment may be less decision useful than one that produces a range of reasonable values from which a value is selected by applying judgment. A method that produces a decision useful outcome should take precedence over one that does not.

14.3.4 In some jurisdictions, enforcement actions can only be based on objective calculations. In those jurisdictions, an objective calculation should take precedence over one based on subjective assumptions and methods. Supervisors may need to provide greater specificity on assumptions (e.g. mortality and interest) and methods for regulatory purposes. Specified

methodology should include a margin for risk that is appropriate for a valuation done for solvency purposes.

14.3.5 Decision useful values may be derived from a range of sources, including market-consistent valuations, amortised cost valuations and other valuation models, such as discounted cash flow projection models.

14.3.6 Where there is a market for an asset or liability in which prices are quoted publicly and trades are readily available, the quoted prices could provide a decision useful value of the asset or liability in the large majority of situations. Typically, there will be a range of market prices for the same item, and judgment will be needed in determining the final value.

14.3.7 In some circumstances, a market price may not necessarily provide a decision useful basis for a valuation. If the reference market is dysfunctional or anomalous in its operation, a more reliable method of determining value based on more normal conditions may be appropriate. Such circumstances may occur, for example, if there is a high cost in making actual trades, trading is thin, independent pricing sources are not available or are limited, or the market is subject to distorting influences. The supervisor should evaluate such circumstances and as a result may conclude that the use of an alternative economic valuation is appropriate.

14.3.8 Amortised cost could be a decision useful value for assets and liabilities where it is a reflection of the amount the insurer will pay and receive over time, and fluctuations in market values are not indicative of the insurer's ability to meet its obligations. Amortised cost may provide a pragmatic and decision useful value when other valuation approaches are no more useful or reliable. It is useful to complement such valuations with sensitivity and adequacy testing.

14.3.9 An insurer's modelling of its assets and liabilities may also provide a decision useful value. The reliability of model results is enhanced through the use of insurers' and supervisors' best practices surrounding model governance, controls and independent review. Supervisory comparisons or benchmarking of modelling practices can further enhance the reliability of modelled results. Models can be used to apply common measurement criteria across all risks (e.g. same methodology, time horizon, risk measure, level of confidence, etc.)

14.3.10 The supervisor should evaluate the extent to which the time value and risk adjustments add decision useful information. Where this is not the case, the disclosure requirements may be relied upon. For liabilities subject to significant litigation uncertainty, it may not be appropriate to include estimates of time value and risk in the reported liability, due to the unreliability of such adjustments.

Transparency

14.3.11 The solvency regime should be supported by appropriate public disclosure and additional confidential reporting to the supervisor. For example, explicit determination of the components of the technical provisions supports the objectives of transparency and comparability and facilitates convergence. Standards for public disclosure including the

valuation of assets and liabilities for solvency purposes can be found in ICP 20 Public Disclosure.

14.3.12 Insurers should provide sufficient information about the approaches they have taken to the valuation of assets and liabilities, describing how the principles of reliability, decision usefulness and consistency have been addressed. Transparency facilitates understanding and comparability within and across jurisdictions.

14.4 The valuation of assets and liabilities is an economic valuation.

14.4.1 An economic valuation is a valuation such that the resulting assessment of an insurer's financial position is not obscured by hidden or inherent conservatism or optimism in the valuation. Such an approach is appropriate in the context of risk-based solvency requirements which satisfy these ICPs and standards and shares their objectives of transparency and comparability.

14.5 An economic valuation of assets and liabilities reflects the risk-adjusted present values of their cash flows.

14.5.1 An economic value should reflect the prospective valuation of the future cash flows of the asset or liability allowing for the riskiness of those cash flows and the time value of money. An asset or a liability may have both cash inflows and cash outflows the net effect of which is a positive or negative value. Such a valuation is not necessarily determined directly using a discounted cash flow calculation. A current quoted market value or a current sale or purchase value may also reflect the prospective valuation of cash flows.

14.5.2 Supervisors should take into account all relevant information available about current market assessments of value and risk and the principles, methodologies and parameters used in the relevant markets for assessing the value of an asset or liability.

14.5.3 The historic cost of an asset or liability may not reflect a current prospective valuation of the future cash flows and may therefore not be consistent with the current economic valuation of other assets or liabilities. Historic cost generally does not reflect changes in value over time. However, amortised cost, which adjusts the historic cost of an asset or liability over time, may reliably reflect the value of future cash flows, when used in conjunction with an adequacy or impairment test.

14.5.4 Some jurisdictions utilise a subset of economic valuation known as market-consistent valuation which is described further in Guidance 14.5.5 to 14.5.11. Some jurisdictions use a subset of economic valuation known as amortised cost valuation which is described further in Guidance 14.5.12 to 14.5.15.

Market-consistent valuation

14.5.5 It may be appropriate to use market-consistent values for the economic valuation of assets and liabilities. A valuation that is based upon principles, methodologies and parameters that the financial markets would expect to be used is termed a market-consistent valuation. Where

a range of assessments and approaches is evident from a market, a market-consistent valuation is one that falls within this range.

14.5.6 It may be well known to financial markets that the approach taken to market assessments for some assets and some insurance liabilities or their components uses modelling based on certain assumptions and techniques and portfolio specific information as well as generally available data on insurance technical risks. A calculation consistent with this approach would be market-consistent.

14.5.7 However, in exceptional circumstances there may be information additional to that on market assessments from the wider economy that should be taken into account e.g. where a market is anomalous, not operating effectively or is subject to intervention from the relevant authorities. For example, where a government/regulator intervenes in a major way e.g. by injecting money or taking control. Such action may be in response to or the cause of distortions of supply and demand in relevant markets so that values determined in a market consistent way may also be distorted temporarily.

14.5.8 A market-consistent value may not then be appropriate and a different value, which may, for example, be expected to be market-consistent under more normal market conditions, may need to be determined to arrive at an economic valuation for solvency purposes. The extent to which this is appropriate is likely to vary according to market conditions in different jurisdictions. If such circumstances arise, supervisors should provide guidance as to the appropriate values or adjustments insurers should use for solvency purposes to reflect the risk-adjusted present value of their cash flows and maintain consistency, decision usefulness, relevance and transparency.

14.5.9 A sufficiently active market may exist for an asset or liability that in itself provides a measure of value that is market consistent. For other assets and liabilities or when the market becomes illiquid, there may be no direct measure of value. However, relevant market information may be available regarding the assessment of components of the rights, obligations or risks of the asset or liability. If, for example, a component of the obligations of an insurance liability can be replicated using financial instruments for which there is a reliable market value, that value provides a reliable indication of the value for this component.

14.5.10 The market-consistent value of an asset or liability may be determined using different techniques, or a combination thereof. For example, in valuing technical provisions:

- if the insurance obligations are traded in a sufficiently deep and liquid market the observed prices may be used to arrive at a market consistent value. The availability, decision usefulness and reliability of the prices should be taken into account when deriving the market consistent value;
- if some or all of the cash flows associated with the insurance obligations can be replicated using financial instruments, the market value of the replicating financial instruments may be used as the value of those cash flows;

- if the cash flows associated with the insurance obligations cannot be replicated perfectly, then the remaining cash flows may be valued using a discounted cash flow model. To be market consistent, the methodology used needs to deliver a proxy for market value based on market consistent valuation principles and to reflect the uncertainty or unavailability of market information.

14.5.11 This approach to valuation is sometimes termed the "components approach", under which risk components are valued at market value where such a value is ascertainable, decision useful and reliable; other components may need to be valued using marked-to-model methods. Separate components may, for example, be identifiable for insurance contracts which have an investment or deposit component and an insurance risk component. The components approach helps to improve market consistency and reduce modelling error. It should be noted that where there is no sufficiently deep liquid market from which to determine a market consistent value for a risk component, the additional liquidity risk needs to be considered.

Amortised cost valuation

14.5.12 It may be appropriate to use an amortised cost method for economic valuation of assets and liabilities. Amortised cost methods determine the value of an asset or liability at any point in time as the present value of future cash flows discounted at an appropriate interest rate, with an appropriate adjustment for risk.

14.5.13 The discount rate used in valuing assets under an amortised cost method equates the present value of expected contractual cash flows with the amount paid to acquire the asset. The price paid for an asset usually equals the market value at time of purchase. Since the price paid reflects the risk of the instrument at the time of purchase, an adjustment for the risk assessed at that time is automatically included in the discount rate.

14.5.14 When valuing both assets and liabilities under an amortised cost method, there is a close relationship between the discount rate and the provision for risk. The discount rate used may be based on the expected yield, after making allowance for default, of the supporting asset portfolio. Other combinations of discount rate and risk adjustment are possible.

14.5.15 When an amortised cost method is used, the values produced should be evaluated for adequacy at least annually. For assets, when the asset has been impaired to a significant degree, the carrying value of that asset should be adjusted to reflect that impairment. For liabilities, the value should be tested at least annually. When the liability value is found to be inadequate, it should be strengthened. Adjustments should also be made to reduce any significant, undue conservatism identified by the adequacy test.

14.6 The value of technical provisions and other liabilities does not reflect the insurer's own credit standing

14.6.1 To achieve consistent and reliable economic values of insurance portfolios for solvency purposes, the value of technical provisions should

not reflect an insurer's own credit standing. Insurance obligations are required to be met to the same level of confidence by all insurers in a jurisdiction and the value of an identical portfolio held by different insurers should not depend on the insurer's credit standing. This also applies to the technical provisions of a reinsurer.

14.6.2 However, the credit standing of a reinsurer should be taken into account when considering the solvency of a ceding (re)insurer even if the contractual cash flows are the same. The risk of reinsurer default could be covered either by the regulatory capital requirements or adjustments made to the value of assets in determining available capital. Alternatively, some allowance for the credit default risk could be made in valuing the reinsurance asset directly.

14.6.3 The valuation of liabilities, other than technical provisions, should also not reflect the insurer's own credit standing.

14.6.4 Where the terms of the debt make it subordinate to the insurer's obligations in respect of insurance contracts, the value of the debt may reflect the lower probability of repayment under subordinated debt and the lower capital needed to cover the risk of non-payment.

14.7 The valuation of technical provisions exceeds the Current Estimate by a margin (Margin over the Current Estimate or MOCE).

14.7.1 Technical provisions are assets or liabilities that represent the economic value of the insurer fulfilling its insurance obligations to policyholders and other beneficiaries arising over the lifetime of the insurer's portfolio of insurance policies. This includes a margin (Margin Over the Current Estimate or MOCE) to cover the inherent uncertainty of those obligations.

14.7.2 The cash flows associated with fulfilling an insurer's insurance obligations include the premiums receivable, the claims payable under the insurance policies, any other policy cash flows (e.g. future distributions under participating contracts) and the future expenses of administering the policies.

14.7.3 Acquisition costs are usually a significant component of an insurer's cash flows. After acquisition costs have been paid future cash inflows may exceed future cash outflows.

14.7.4 Because an insurer's obligations under an insurance policy are inherently uncertain as to amount and/or timing, the present value of the cash flows associated with fulfilling them has a range of possible values with varying probabilities. The probability-weighted average of these present values is their expected present value (also called the statistical mean) and is termed the "current estimate of the cost of meeting the insurance obligations" (Current Estimate). Actuarial and statistical techniques may be used in determining the current estimate, including deterministic, analytical and simulation techniques.

14.7.5 In addition to covering the cash flows associated with fulfilling insurance obligations, an insurer incurs the cost of covering the uncertainty inherent in those cash flows (e.g. through holding capital, or through hedging, reinsurance or other forms of risk mitigation). Insurers are required to maintain an amount such that the obligations under insurance policies will be fulfilled with the claimant or beneficiary when they fall due. In principle,

therefore, an economic value of the technical provisions exceeds the current estimate of the cost of meeting the insurance obligations by an amount covering this uncertainty. This excess is the MOCE.

14.7.6 Where, for example, capital is required to give the level of confidence required by the solvency regime, the technical provisions should at minimum also cover the cost of holding that capital. In these circumstances, the MOCE might be seen as a provision for rewarding the capital committed to the business over the outstanding lifetime of the policy. As the uncertainty reduces over time, so the MOCE will also reduce, gradually releasing it from the technical provisions. Equally, as uncertainty reduces, the required capital would also reduce in line with the revised risk profile.

14.7.7 It may not be necessary, in practice, to determine the current estimate and the MOCE separately. The solvency regime should require any method by which technical provisions are valued to be such that the value includes an explicit or implicit margin over the current estimate. For example, a reliable market valuation by reference to a sufficiently deep and liquid market may be expected automatically to include a MOCE.

14.7.8 A model which includes in its calculations an allowance for uncertainty up to the level of confidence required by the solvency regime is also capable of calculating the technical provisions directly. However, in this case, supervisors should consider whether the current estimate and MOCE should be separately reported to help ensure that technical provisions are consistent and reliable.

14.7.9 A change in underlying data or assumptions generating a change in current estimate and MOCE should be disclosed and justified so that consistency, reliability and relevance may be maintained and arbitrary changes over time are avoided.

14.8 The Current Estimate reflects the expected present value of all relevant future cash flows that arise in fulfilling insurance obligations, using unbiased, current assumptions.

14.8.1 The current estimate should reflect all future cash flows under an existing insurance contract to the extent that they are integral to the fulfilment of the obligations under that contract. This encompasses all cash flows, including non-guaranteed optional or discretionary cash flows, where they are established as stemming from the contractual relationship between the insurer and the policyholder. This reflects the commercial substance of the contract and therefore reflects economic reality.

14.8.2 An insurance contract should be considered as a whole. In particular, where the contract provides for the payment of future premiums, such premiums are integral to the fulfilment of the obligations under that contract. Neither the company nor the policyholder is able to deal with one without simultaneously dealing with the other. To recognise one, the other must also be recognised. Valuation of the insurance liability requires consideration of all of the associated cash flows, including the contractual, premium inflows. The uncertainty associated with those cash flows along with that of the other relevant cash flows are reflected in the probability weightings applied in calculating the current estimate.

14.8.3 To give clarity as to what constitutes an insurance contract for solvency purposes, the supervisory regime should specify the boundaries for insurance contracts which define the relevant cash flows to be included in determining the current estimate. The insurance contracts are subject to the following boundary constraints, if they exist[28]:

- contractual termination as extended by any unilateral option available to the policyholder, or
- the insurer having a unilateral right to cancel or freely re-underwrite the policy, or
- both the insurer and policyholder being jointly involved in making a bilateral decision regarding continuation of the policy.

14.8.4 The first boundary constraint excludes new business arising from the "rolling-over" of the existing contract, except where such "roll-over" is due to the exercising of an explicit option available to the policyholder under the current contract. Contractual cash flows arising from policyholders' unilateral in-the-money options to extend the contractual termination date should be included. The current estimate should allow for the expected rate of exercising such options. This boundary constraint also excludes additional voluntary contributions premiums, except where provided for as a unilateral option under the contract. For insurance contracts with variable premiums (such as universal life contracts), the cash-flows should include voluntary contributions above the minimum required to the extent that there are guarantees, under the current contract e.g. no-lapse and premium rate guarantees. The current estimate should reflect the expected rate of payment of additional contributions and the expected level of such contributions.

14.8.5 The second boundary constraint clarifies that future cash flows arising from events beyond the point where the insurer can unilaterally cancel the contract – for example, by re-underwriting are not included in the valuation. This is the case with most non-life insurance contracts which are typically written for only one year. Although there might be a high expectation that they would be renewed, the insurer is not bound to do so, and accordingly only cash flows arising in respect of the currently in-force or in run-off contracts, are included for valuation purposes, whereas the impact of new business might be considered in capital requirements or capital resources by the solvency regime. By contrast, future cash flows under a life or disability contract which the insurer cannot unilaterally cancel should be included, even if the future premiums under such a contract are planned to increase, or able to be varied by the insurer in respect of the entire class of contracts without individual underwriting.

14.8.6 The third boundary constraint clarifies that even if the policyholder has an option to continue or increase the contract, if it requires the insurer's consent then cash flows arising from events beyond that point should not be included for valuation purposes, whereas the impact of new business

[28] For certain types of long-duration life policy with an indefinite term, these would be evaluated through the potential life of the policyholder, allowing for lapse or surrender in the probabilities attached to each cash flow.

might be considered in capital requirements or capital resources by the solvency regime

Discretionary payments

14.8.7 Some insurance contracts give the policyholder both guaranteed benefits (e.g. a minimum amount payable on death and/or maturity or any insured event) and for example, a right to participate in the performance of the relevant class of contracts, related assets or both. The insurer has some discretion over the amount or timing of the resulting distributions to policyholders, but there are often constraints over that discretion.

14.8.8 When establishing the future cash flows to include in the determination of technical provisions for solvency purposes, consideration should therefore be given to all payments whether or not these payments are contractually guaranteed under an insurance contract. For example, future discretionary bonuses which the insurer expects to make should be included.

14.8.9 In view of the wide variety of participating contracts and legal frameworks in different jurisdictions, supervisors should establish criteria appropriate to their jurisdictions for the allowance of discretionary elements associated with participating contracts in the valuation of technical provisions. These should nonetheless reflect the principles of a consistent, reliable and economic valuation and those that apply more specifically to technical provisions, as discussed in this ICP.

14.8.10 In many jurisdictions, accumulated profits attributable to a class of policyholders are accounted for separately by the insurer. Where such accumulated profits can be used to absorb losses to protect policyholder interests in a period of stress, they may possess all the characteristics of capital and may hence be recognised in the determination of capital resources for solvency purposes. In such a case, it is important to ensure that the criteria established by the solvency regime for the allowance of future discretionary benefits in the valuation of technical provisions are compatible with the criteria for determining capital resources in order to achieve a consistent overall assessment of the solvency position of the insurer.

Unbiased current assumptions

14.8.11 Unbiased current assumptions are derived from a combination of relevant, credible experience as well as judgment about its expected future development, e.g. improving mortality rates, inflation of expenses that neither deliberately overstates nor understates the expected outcome. Reconsideration of data and assumptions should occur every time the technical provisions are valued, with revisions made as appropriate to ensure data and assumptions remain appropriate to current conditions.

14.8.12 Observable data, such as interest rates, financial market prices and inflation rates may be expected to be different each time the current estimate is determined. In particular, cash flows are sensitive to inflation rates. Where assumptions are derived from observed values in the

market, these should be the observed values current at the date of the valuation.

14.8.13 Regular experience analysis, considering the individual entity and relevant industry experience where appropriate, should be undertaken to support the assumptions used for insurance technical risks. Where assumptions depend on the results of such experience analyses, the most recent experience for the portfolio need not necessarily represent the most credible current assumption for that portfolio. Greater credibility may be achieved by the analysis of several years' experience, smoothing out fluctuations in experience and allowing appropriately for any trends in experience that may be evident. However, care should also be taken that historical experience remains relevant to current conditions.

14.8.14 Where the credibility of an insurer's own experience is low, for example for a small or new portfolio of insurance contracts, assumptions based on the relevant industry experience are likely to be more decision useful as a basis for projecting its cash flows.

14.8.15 The assumptions used should, in principle, reflect the characteristics of the portfolio rather than those of the particular insurer holding that portfolio. However, it is important to note that, in practice, the characteristics of the portfolio underwritten by an insurer may reflect aspects of an insurer's specific business practices, particularly with regard its underwriting, claims handling and expenses. Company-specific information may be appropriate, for example, where the insurer's business model and practices are sufficiently substantiated as representative of the portfolio and similar information is used in market valuations.

14.8.16 With respect to expenses, the insurer's own expense experience in managing a portfolio is likely to be relevant in determining an economic value.

14.8.17 Acquisition costs are typically a major component of an insurer's expenses. For most insurance contracts, acquisition costs will already have been incurred so that future cash flows include only maintenance and claims costs. An appropriate analysis of the insurer's expense experience is needed to separate out acquisition costs in order to model future expenses. Care is needed to allow for expenses that do not vary directly with the level of new business so that expenses that will continue to be incurred for a period if new business ceases are taken into account.

14.9 The MOCE reflects the inherent uncertainty related to all relevant future cash flows that arise in fulfilling insurance obligations over the full time horizon thereof.

14.9.1 Different methods may be used in practice to measure risk. For some risks, observable market prices for risk may be available. In choosing a methodology, due consideration should be given to the nature of the risks being measured. Other approaches being considered around the world include quantile, conditional tail expectation, cost of capital and explicit assumption methods. Where a mixture of appropriate methods is used, a consistency check should be considered. Calibration of the methods used should reduce the effect of methodological differences to a level sufficient to enable reliable solvency assessment to be undertaken. At present,

there is no one common methodology. In practice, the results from different methods will not be identical and calibration and consistency checks should be applied so that methodological differences are reduced to an acceptable level for solvency assessment purposes. Once established, the methodology should not be changed from one valuation to the next unless there is a reasonable rationale for change.

14.9.2 The margin over current estimate (MOCE) represents an estimated measure of the uncertainty inherent in the cash flows associated with fulfilling an insurer's insurance obligations. To achieve a consistent, reliable and decision useful valuation, the margin over current estimate should consider all of the inherent uncertainty attached to the policy obligations over the full period of those obligations i.e. the variability of all relevant future cash flows to the extent to which this uncertainty is borne by the insurer and not the policyholder.

14.9.3 Only risk inherent to the policy obligations should be reflected in the MOCE. Other risks should be reflected in regulatory capital requirements. Where risks are reflected in both the MOCE and regulatory capital requirements to provide an overall level of safety, double counting should be avoided as far as practical.

14.9.4 In some jurisdictions it may be considered appropriate, due to inherent uncertainty in policy obligations and profit, that no component of premium related to such considerations should be recognised in profit at the inception of a contract. In those jurisdictions, the inherent uncertainty is effectively represented by the difference between premium received and the Current Estimate. Other jurisdictions may take the view that one of the other methodologies described in this document provides a decision useful separate estimate of the level of uncertainty in determining the MOCE and may therefore allow potential gain at issue to be recognised.

14.9.5 It is important to be clear about the extent to which risk factors should be reflected when valuing the MOCE and to what extent. It is appropriate to differentiate between the risks specific to the portfolio of insurance obligations and the risks associated with the operations of the particular insurer. Risks that are portfolio specific are inherent to the policy obligations and should be taken into account in the MOCE.

14.9.6 In determining the appropriate methodology for determining the MOCE in a solvency regime, the supervisor should consider the extent to which possible methodologies promote transparency and comparability between insurers and insurance markets.

14.9.7 An appropriate method for the determination of the MOCE would be expected to exhibit the following characteristics:

- Insurance obligations with similar risk profiles have similar MOCEs;
- The less that is known about the cash flows; the higher the MOCE;
- For the same level of probability, risks with higher impact have higher MOCEs than those with lower impact;

- Risks with low frequency and high severity will generally have higher MOCEs than risks with high frequency and low severity;
- For risks of the same or a similar nature, contracts that persist over a longer timeframe will have higher MOCEs than those of shorter duration;
- Risks with a wide probability distribution have higher MOCEs than those risks with a narrower distribution; and
- To the extent that emerging experience reduces uncertainty, MOCEs should decrease, and vice versa.

14.9.8 In establishing appropriate criteria or methods for determining the MOCE, the supervisor should consider the diversification of the inherent risk factors reflected in the MOCE.

14.9.9 Consideration should be given to the segmentation of the insurance policies of the insurer into separate portfolios and the impact this has on the diversification of inherent risk factors that is taken into account. Segmentation, e.g. by line of business, may be undertaken for calculation purposes and may mean that diversification within portfolios is taken into account in the MOCE but diversification across portfolios is left out of account. The calculation method may also mean that diversification within portfolios is only partially taken into account. Any residual diversification within portfolios and all diversification across portfolios could for example be addressed as an offset to regulatory capital requirements, if appropriate. The MOCEs for the total business of the insurer would simply be the sum of the MOCEs of its portfolios.

14.9.10 Where an element of an insurance liability, i.e. an insurance obligation or risk in whole or in part, can be replicated or hedged by a financial instrument which has a reliable value, the value of that instrument provides a reliable value for that element of the liability including an implicit MOCE. In practice, such hedging is rarely perfect in all scenarios and there are some differences between the insurance cash flows and those of the replicating instrument which need to be valued separately. Where a model is used for this valuation, calibration of the model to the value of hedging instrument used is likely to assist in achieving overall consistency and reliability. Such practice should be encouraged by supervisors.

14.10 The valuation of technical provisions allows for the time value of money. The supervisor establishes criteria for the determination of appropriate rates to be used in the discounting of technical provisions.

14.10.1 The solvency regime allows for the time value of money to be recognised in the determination of technical provisions and should establish criteria for the determination of appropriate interest rates to be used in the discounting of technical provisions (discount rates). In developing these criteria, the supervisor should consider the following:

- the economics of the insurance obligations in its jurisdiction including their nature, structure and term; and
- the extent (if any) to which benefits are dependent on underlying assets.

14.10.2 The criteria for determining appropriate interest rates to be used in the discounting of technical provisions should recognise that the appropriate interest rates may not be directly observable and apply adjustments based on observable economic and market data of a general nature as appropriate.

14.10.3 To the extent that a risk is provided for elsewhere in the balance sheet by alternative means, there should be no allowance for that risk in the chosen discount rates.

14.10.4 As the discount rates should reflect the economics of the insurance obligations, any observed yield curve should be adjusted to account for differences between the economics of the observed instrument with those of the insurance obligations.

14.10.5 The criteria should also allow appropriate interpolation and extrapolation for non-observable market data and maturities. To provide for consistent, reliable, economic values, the criteria for discount rates should utilise the entire interest rate term structure.

14.10.6 In principle, if an investment has a reliable market value and fully replicates or hedges an element of the insurance obligations or risks, such a value is presumed to reflect the time value of money.

14.11 The supervisor requires the valuation of technical provisions to make appropriate allowance for embedded options and guarantees.

14.11.1 The determination of the current estimate and MOCE should make explicit allowance for any options of the policyholder or insurer and for guarantees embedded in the insurance contract, such as guaranteed minimum benefits and interest rate guarantees. The method used to value embedded options and guarantees should be appropriate to the nature, scale and complexity of risk and may include stochastic simulation or simplified methods as appropriate.

14.11.2 An important policyholder option is the option to lapse and, for some life products, to receive payment of a surrender value. Explicit allowance for lapses and surrenders should be incorporated in the projections of future cash flows that are used to determine technical provisions. The risks of lapse and surrender need to be considered over the full time horizon of the insurance contract. Historical experience of lapses and surrenders is decision useful in considering the setting of assumptions about future experience used for calculating a current estimate and MOCE. The uncertainty associated with lapses and surrender may not be fully diversifiable across insurance contracts as the level of lapses and surrenders may depend on economic conditions or perceptions about the performance of the insurer which apply generally to policyholders. This is offset by variations in policyholders' responses to such conditions or perceptions and their personal motivation for lapse and surrender. Such factors should be taken into account when assessing the risk of lapse and surrender.

14.11.3 Technical provisions are not required to be subject to a surrender value floor equal to the total surrender values payable if all policies were to surrender immediately. Such an approach would not be an economic valuation as the effect of surrenders is already allowed for in the technical

provisions by incorporating assumptions about the future rate of surrender and associated risks. However, in the determination of the overall financial requirements for solvency assessment purposes, a form of surrender value minimum may be considered appropriate, to provide additional protection in the event of a high level of surrenders. This should be reflected in regulatory capital requirements, as appropriate.

ICP 15 Investment

The supervisor establishes requirements for solvency purposes on the investment activities of insurers in order to address the risks faced by insurers.

Introductory Guidance

15.0.1 This ICP does not directly apply to non-insurance entities (regulated or unregulated) within an insurance group but it does apply to insurance legal entities and insurance groups with regard to the risks posed to them by non-insurance entities.

Basis for establishing regulatory investment requirements

15.1 The supervisor establishes requirements that are applicable to the investment activities of the insurer.

15.1.1 The nature of insurance business necessitates the establishment of technical provisions and loss-absorbing capital. This, in turn necessitates the investment in and holding of assets sufficient to cover technical provisions and capital requirements. The quality and characteristics of an insurer's asset portfolio and the interplay and interdependence between the insurer's assets and its liabilities are central to an assessment of an insurer's solvency position, and hence, are important aspects to be addressed by the supervisor and for an insurer to manage.

15.1.2 There are various reasons for insurers to make investments (e.g. capital appreciation, hedging or cash flow expectation) and there is a wide variety of assets that insurers may invest in, with the risk profiles of different investments varying widely. Some assets, such as equities and property are subject to unpredictable short term price movements. Other assets such as corporate and government bonds have fixed or defined income, with uncertainty related to the price at which these assets can be sold before maturity and the extent to which the counterparty is able to make fixed income payments and repay the principal. Unless restricted, derivatives may be used for speculative or hedging purposes and some may be subject to wide variations in their value and involve unlimited commitments.

15.1.3 Financial requirements are not sufficient by themselves to ensure solvency and should be complemented with appropriate quantitative and/or qualitative requirements limiting/regulating the investment risks that are taken by the insurer. This guards against the possibility that the regulatory capital requirements and the insurer's own risk and solvency assessments do not fully cover the risks inherent in those activities.

15.1.4 In establishing regulatory investment requirements, factors considered may include:

- the overall quality of risk management and governance frameworks in the insurance industry in the jurisdiction;

- the way in which the quality of capital resources is addressed by the supervisor, including whether or not quantitative requirements are applied to the composition of capital resources;
- the comprehensiveness and transparency of disclosure frameworks in the jurisdiction and the ability for markets to exercise sufficient scrutiny and impose market discipline;
- the development of relevant investment and capital markets locally and internationally and the range of available financial instruments;
- the cost of compliance, the impact on innovation and the effect on the efficiency of industry practices keeping in mind that the protection of policyholders is the main focus of prudential regulation;
- noting that insurers compete with other financial services institutions, the requirements on the investment activities of other financial services entities, including banks; and
- the level of prudence and risk-sensitivity of the regulatory solvency requirements and the risks that they cover.

15.1.5 Regulatory investment requirements may take many forms and may influence the investment strategies of the insurer. Requirements may be rules-based, setting out specific rules or restrictions on the investment activities of the insurer. For example, the requirements may set out quantitative limits on the asset types in which the insurer can invest. Alternatively, requirements may be principles-based, such that there is no specific restriction on the asset strategy taken by the insurer, as long as defined principles are met.

15.1.6 Regulatory investment requirements may be a combination of rules-based and principles-based requirements, setting out some specific rules or restrictions and some principles with which the insurer's investment strategy should comply. Broadly, regulatory investment requirements should provide the basis and incentives for the implementation of effective risk management by the insurer.

15.1.7 Rules-based requirements may be used to prohibit or limit specific classes of investment. Such requirements may be used, for example, for classes that have very volatile payouts, such as commodities, certain derivatives, asset classes where the counterparty is below a certain credit rating, unsecured loans, unquoted shares and exposures to closely related companies. Rules may also be defined to restrict exposure to any single counterparty, group, or homogeneous risk group (such as industry and geographical area) to, for example, a defined percentage of the total assets or capital base. Such rules or restrictions may either be applied directly to the investments or lead to charges to or deductions from available capital which act as a disincentive to investment in risky assets or high concentrations in particular assets rather than as a prohibition.

15.1.8 Rules-based requirements may be relatively easy to enforce by supervisors, as there is limited scope for different interpretations of the

rules. Similarly, they may be more readily explainable to a court when seeking enforcement of supervisory action. A further advantage of rules-based requirements is that the supervisor is able to prohibit or deter the insurer from investing in an asset class that it believes is not appropriate for it to hold.

15.1.9 However, rules-based regulatory requirements may stifle innovation and may restrain the insurer from holding the assets that it believes are most appropriate for meeting its financial objectives. For example, an insurer may want to use derivatives in a hedging strategy to protect it from adverse market movements, but derivatives may be on the list of restricted assets. This may result in an ineffective risk management process, or prevent the insurer from developing innovative contracts to meet policyholder needs. Also, since the nature of business and structure of liabilities differ among insurance companies, a uniform rule-based regulatory requirement on investment, which is applicable to all insurers, may discourage insurers from developing their own risk management.

15.1.10 One advantage of principles-based requirements is that there is more flexibility for the insurer in its choice of particular investments and therefore to follow an investment strategy that it believes is the most appropriate to its risk profile, risk tolerance and overall financial objectives. The insurer will be able to select and follow the investment strategy to best manage its investment risks. Another advantage of principle-based requirements is that they may not need to be revised so frequently in response to innovations in the investment market. A potential disadvantage of a solely principles-based investment regime is that it may allow certain innovative investments which prove to be riskier than originally assessed. It may also be more difficult for the supervisor to take enforcement actions as principles-based investment requirements admit some scope for differences in interpretation.

15.1.11 The supervisor should establish investment requirements having regard to such requirements applied in other, non-insurance, financial sectors. It is important that requirements are consistent to the extent possible, in order to prevent groups from transferring assets between the entities in the group to take advantage of regulatory arbitrage. Consistency of regulation between sectors assists in maintaining a level playing field and enhances fairness. However, such requirements should take into account the differences in risk profiles and risk management between sectors.

Additional guidance for insurance groups

15.1.12 For insurance groups, the supervisor should specify how investments should be aggregated for the purposes of regulatory investment requirements that apply to the group and consider appropriate restrictions on intra-group transactions, for example, to limit contagion or reputational risk. Issues to be considered may include exposures to related counterparties and the exposures arising from investments in subsidiaries and interests over which the insurer has some influence. In stress situations there will tend to be greater restrictions on movements and realisation of investments within the group. The regulatory regime may therefore require contractual evidence of the ability to access assets for solvency purposes before allowing their inclusion for group purposes.

15.2 The supervisor is open and transparent as to the regulatory investment requirements that apply and is explicit about the objectives of those requirements.

15.2.1 Openness and transparency of the supervisory investment requirements are required to facilitate its effective operation. The supervisor should be explicit as to the objectives of setting regulatory investment requirements. This is particularly important with regard to the consistency of such requirements with other building blocks of the regulatory solvency assessment of the insurer, such as the valuation of assets and liabilities, the calculation of regulatory capital requirements and the determination of available capital resources.

Additional guidance for insurance groups

15.2.2 A supervisor for insurance groups should be explicit as to the requirements that apply both on a group-wide basis as well as to insurance legal entities within the group and should address issues specific to groups, such as requirements for liquidity, transferability of assets and fungibility of capital within the group.

15.2.3 In respect of group solvency, transparency allows appropriate comparisons with other solvency requirements. The openness and transparency of the regulatory investment requirements in the jurisdictions in which an insurance group operates also facilitates the effective individual solvency assessment of insurers which are members of the group and its corresponding group-wide solvency assessment.

Regulatory investment requirements regarding asset portfolio

15.3 The regulatory investment requirements address at a minimum, the

- **Security;**
- **Liquidity; and**
- **Diversification;**

of an insurer's portfolio of investments as a whole.

15.3.1 The supervisor should require the insurer to invest assets in such a manner that, for the portfolio as a whole:

- assets are sufficiently secure;
- payments to policyholders or creditors are able to be made as they fall due (liquidity);
- assets are held in the appropriate location for their availability; and
- assets are sufficiently diversified.

15.3.2 Insurance legal entities should be able to demonstrate that they meet the regulatory investment requirements as well as enterprise risk management requirements.

Additional guidance for insurance groups

15.3.3 In addition to meeting the qualitative and quantitative investment requirements at an insurance legal entity level, the insurance group should monitor[29] investment risk exposures on an aggregate basis for the group as a whole.

15.3.4 The investment requirements should consider cases where losses from investments made by entities of an insurance group have the ability to weaken another entity or the group as a whole through intra-group investments (for example if there is explicit or implicit support from another entity).

15.3.5 The assets of an entity within an insurance group may include participations or investments in another entity within the same group. Appropriate investment requirements should apply to such investments or participations which have particular regard to their lack of liquidity. Relatively small holdings in another insurance group entity which does not give the investor control over the investee may, for example, be subject to the same requirements that apply to investments in entities external to the group. On the other hand, for larger holdings which give the investor control or significant influence over the investee, consideration should be given to aggregating the assets of the investee with those of the investor for the purposes of applying investment requirements. This is done so that adequate security, liquidity and diversification are maintained and that the investor, using its control over the investee, ensures the investee's investment activities are consistent with its own investment policy.

Security

15.3.6 The supervisor requires that the insurer's investments are sufficiently secure both individually and for the portfolio as a whole. A sufficient degree of security of investments is essential so that obligations to policyholders can be met. The security of an investment is related to the protection of its value and to the preservation of its economic substance. Hence it may be necessary to establish regulatory investment requirements to restrict the insurer's selection of, and/or exposure to, investments that have low security or whose security is difficult to assess reliably.

15.3.7 The security of an investment is affected by the risk of default of a counterparty with which the investment is made, as well as the risk that it will lose its value (including currency risk, discussed in Guidance 15.4.1). Security is also affected by the safekeeping, custodianship or trusteeship of its investments. The insurer should ensure that its overall portfolio is sufficiently secure.

15.3.8 Where external credit ratings of the investment are available, these may assist the insurer in determining the security of the counterparty and the associated risk of default. However, the insurer should be aware of the limits of using credit ratings and, where appropriate, conduct its own due diligence to assess the counterparty credit risk exposure. The supervisor

[29] Monitoring in this context does not imply that the assets are managed centrally but that, at a minimum, the asset risks are aggregated and considered, and acted on, appropriately.

may also establish requirements on the appropriate use of credit ratings by the insurer to ensure a sufficient degree of security of investments.

15.3.9 To assess the security of its investments, it is important that the insurer is capable of assessing the nature, scale and complexity of the associated risks. This may be difficult in cases where there is a lack of transparency as to the underlying risk profile of an investment. This may be the case for indirect investments through a collective investment fund or for investments in more complex financial instruments such as structured asset products. When an insurer invests in some markets, there may also be a lack of transparency or clarity in respect of the market, regulatory and legal systems that apply and the degree of protection that they provide.

15.3.10 For those assets which are lacking in transparency, the risk profile should be carefully analysed by the insurer. The insurer should look through to the underlying exposure of the investment as far as possible as well as considering the additional risks introduced by and inherent in the investment structure. For example, additional legal risks may arise if investments are located outside of the insurer's operating jurisdictions. Potential obligations to make future payments under the assets should be identified and adequately covered.

15.3.11 The security of derivative products should be evaluated by taking into account the assets underlying the derivative, as well as the security of the counterparty providing the derivative, the purpose for which the derivative is held and the cover (such as collateral) the insurer has for exposures under the derivative contract. In some cases, counterparties may provide collateral to improve security by giving the insurer the right to the collateral if the counterparty fails. Similarly, the security of investments may be improved by guarantees from more secure third parties.

15.3.12 Some investments that are not themselves derivatives may embed a derivative, thereby having an effect on the insurer corresponding to the derivative itself. Some commitments may be transacted through Special Purpose Entities (SPEs) which may be "off-balance sheet" in some jurisdictions. Such commitments which are similar to derivatives have similar security issues and the regulatory investment requirements should address these commitments in a consistent manner.

15.3.13 When an insurer lends securities, it must consider both the risk inherent in the counterparty to which the securities are lent and the risk of the securities themselves. The insurer should seek to ensure that securities lending transactions are appropriately collateralised (with suitably frequent updating) and should recognise that lending a security does not mitigate the risk it poses to the insurer, even if doing so removes the security from the balance sheet. Care should be taken by the insurer when investing the collateral it holds that it will continue to cover the lending under adverse market conditions and that it will be returnable in the required form when due.

Additional guidance on security for insurance groups

15.3.14 The supervisor should make appropriate allowance for the possibility of an aggregation of exposures in an insurance group compounding security

issues that may be relatively less important when considered at *i*ndividual entity level. Correspondingly, the supervisor should guard against a group investing in assets that are not secure and which may then be distributed around the group to avoid investment restrictions, by requiring appropriate consolidated disclosure.

Liquidity

15.3.15 The insurer is required to pay benefits to the policyholder when the benefits become due. In order to do so, the insurer needs to have available assets which can be used to generate cash when it needs to do so. This includes disposal of assets for an amount (in the relevant currency) equal to the value it ascribes to that asset in addition to cash from income on assets that the insurer retains.

15.3.16 The ability of the insurer to remain in a liquid position may be adversely impacted if, for example, the insurer pledges or hypothecates its assets, it experiences an unexpectedly large claim, there is an event resulting in many claims or a derivative needs to be serviced. A large cash outflow may impact the liquidity of the insurer leaving it with less liquid assets to make other policyholder payments.

15.3.17 The ability to realise or liquidate an investment at any point in time is important. For example, where an investment is made in a closed fund, it would usually not be possible to resell the interest in the fund. This may also impede the security of the investment in terms of its ability to settle obligations towards policyholders. Similar considerations would need to be given for property used by the insurer which might be hard to liquidate without disrupting its operations.

Additional guidance on liquidity for insurance groups

15.3.18 The legal and practical impediments to cross-border movement of assets should also receive due regard. It is unlikely that available capital, however liquid within a jurisdiction, will be perfectly mobile across jurisdictional borders, particularly in a crisis. Therefore insurers and home and host supervisors should have due regard to the nature of the potential legal and practical impediments to cross-border transfer of assets as well as any potential effect those impediments might have, particularly in a winding up.

15.3.19 Group issues are also relevant when managing liquidity risk both in terms of the availability of additional liquidity and the possible need to provide liquidity support to other parts of the group.

15.3.20 Very often, the entities within a group engage in intra-group transactions (e.g. swaps, inter-company loans) in order to offset risks that exist within different parts of the group, or so that more mature businesses may support growing businesses within the group. Such transactions should be done using appropriate transfer pricing based on current market conditions so that there is appropriate recognition of the impact of these transactions for each of the entities involved and the group as a whole.

15.3.21 Liquidity of assets and fungibility of capital are especially important if the group relies on diversification between entities without each entity being

fully capitalised on a stand-alone basis (where the supervisor allows this scenario).

Diversification

15.3.22 Diversification and pooling of risks is central to the functioning of insurance business. To mitigate the risk of adverse financial events, it is important that the insurer ensures that its overall investment portfolio is adequately diversified and that its asset and counterparty exposures are kept to prudent levels.

15.3.23 It is useful to draw a distinction between diversification within a risk category and diversification between risk categories. Diversification within a risk category occurs where risks of the same type are pooled (e.g. shares relating to different companies). It is related to the statistical property that the volatility of the average of independent, identically distributed random variables decreases as the number of variables increases. Diversification between risk categories is achieved through pooling different types of risk. For example, where the insurer combines two asset portfolios whose performances are not fully correlated, the exposure to the aggregated risks will generally be lower than the sum of the exposures to the risks in the individual portfolios.

15.3.24 With respect to its investment portfolio, the insurer should ensure that it is diversified both within as well as between risk categories taking into account the nature of the liabilities. Diversification between investment risk categories could, for example, be achieved through spreading the investments across different classes of assets and different markets. To achieve diversification within a risk category, the insurer needs to ensure that with respect to a given type of risk the investments are sufficiently uncorrelated so that – through pooling of individual assets – there is a sufficient degree of diversification of the portfolio as a whole.

15.3.25 To ensure that its investment portfolio is adequately diversified, the insurer should avoid excessive reliance on any specific asset, issuer, counterparty, group, or market and, in general, any excessive concentration or accumulation of risk in the portfolio as a whole. As an example the insurer might consider its asset concentration by type of investment product, by geographical dispersion, or by credit rating. The insurer should also ensure that its aggregate exposure to related entities is considered and that different types of exposure to the same entity/group are also considered e.g. equity investment in a reinsurer which is also providing its reinsurance cover.

Additional guidance on diversification for insurance groups

15.3.26 Monitoring investments on a group-wide basis is more likely to make management aware of issues (e.g. asset concentrations) that could be overlooked if only the individual legal entities are monitored. Groups that are unaware of their global exposures could end up with an inappropriate level of exposure to certain investments, creating financial difficulties within the group if the value or liquidity of these investments decreases.

Regulatory investment requirements relating to the nature of the liabilities

15.4 The supervisor requires the insurer to invest in a manner that is appropriate to the nature of its liabilities.

15.4.1 The assets that are held to cover policyholder liabilities and those covering regulatory capital requirements should be invested in a manner which is appropriate to the nature of the liabilities as the insurer will need to use the proceeds of its investments to pay the policyholders and other creditors, as and when the payments to them fall due. The insurer's investment strategies should take into account the extent to which the cash flows from its investments match the liability cash flows in both timing and amount and how this changes in varying conditions. In this context, the insurer should specifically consider investment guarantees and embedded options that are contained in its policies. It should also consider the currency or currencies of its liabilities and the extent to which they are matched by the currencies of the assets. To the extent that assets and liabilities are not well matched, movements in financial variables (e.g. interest rates, market values and exchange rates) could affect the value of the assets and the liabilities differently and result in an adverse economic impact for the insurer.

15.4.2 This requirement to take into account the characteristics of the liabilities does not necessarily place a requirement on the insurer to employ an investment strategy which matches the assets and the liabilities as closely as possible.

15.4.3 As liability cash flows are often uncertain, or there are not always assets with appropriate cash flow characteristics, the insurer is usually not able to adopt a completely matched position. The insurer may also wish to adopt a mismatched position deliberately to optimise the return on its business. In such circumstances, the supervisor may require the insurer to hold additional technical provisions and/or capital to cover the mismatching risk. The regulatory investment requirements may also constrain an insurer's ability to mismatch its assets and liabilities as the extent of mismatching should not expose policyholders to risks that cannot be effectively managed by the insurer.

15.4.4 However, close matching of assets and liabilities is usually possible and should be considered as a potential requirement in the case of unit-linked or universal life policies where there is a direct link between policyholder benefits and investment funds or indices. It may not otherwise be possible for the mismatching risk to be covered effectively by capital. Where a regime requires assets to be closely matched to such liabilities, other restrictions on investments may be appropriate to contain the investment fund risk being borne directly by policyholders.

15.4.5 The insurer should manage conflicts of interest (e.g. between the insurer's corporate objectives and disclosed insurance policy objectives) to ensure assets are invested appropriately. For with-profits liabilities, an insurer should hold an appropriate mix of assets to meet policyholders' reasonable expectations.

Additional guidance for insurance groups

15.4.6 Investments that back liabilities including those covering regulatory capital requirements within one of a group's legal entities should be

tailored to the characteristics of the liabilities and the needs of the legal entity and not subject to undue influence from the wider objectives of the group.

Regulatory investment requirements regarding risk assessability

15.5 The supervisor requires the insurer to invest only in assets whose risks it can properly assess and manage.

15.5.1 The insurer should ensure that its investments, including those in collective investment funds, are sufficiently transparent and should limit its investments to those where the associated risks of the asset can be properly managed by the insurer i.e. where the insurer can identify, measure, monitor, control and report those risks and appropriately take them into account in its own risk and solvency assessment.

15.5.2 The insurer should understand all of the risks involved sufficiently well before any such investments are undertaken. Such an understanding is necessary in order to assess how material the risk from a proposed investment is to an insurer. Assessments of risks should take into account the maximum loss possible in a transaction, including losses that may occur in situations where assets or derivatives become liabilities for the insurer.

15.5.3 Where the insurer is able to look through the structure of the investments to the underlying assets, the insurer should consider the risk characteristics of the underlying assets and how this affects the risk characteristics of the investments itself. However, where look through is not possible, appropriate techniques should be developed to assess the risks associated with the investment, e.g. by assessing the investment manager of an investment fund.

15.5.4 Investments which are not admitted to trading on a regulated financial market should be kept to prudent levels as the assessment of their risks may be subjective. This is particularly relevant where standardised approaches to determining regulatory capital requirements are used, since such standardised approaches will often be designed to be not unduly complex and thus feasible in practice for all insurers, whilst delivering capital requirements which reasonably reflect the overall risk to which the insurer is exposed. Moreover, by its very nature a standardised approach may not be able to fully and appropriately reflect the risk profile of the investment portfolio of each individual insurer.

Additional guidance for insurance groups

15.5.5 Investments held by entities within a group are sometimes managed centrally, with the entities relying on expertise provided by the group head office or specialist central unit. Such arrangements may be acceptable if the investment management unit has the requisite knowledge and skills to assess and manage the risks of these investments and manages the investments with due regard to the needs of the entity in addition to the group as a whole.

Regulatory investment requirements relating to specific financial instruments

15.6 The supervisor establishes quantitative and qualitative requirements, where appropriate, on the use of more complex and less transparent classes of assets and investment in markets or instruments that are subject to less governance or regulation.

15.6.1 Complex investments pose additional risks in that large, sudden and/or unexpected losses can occur. For example, off-balance sheet vehicles have led to losses arising from implicit obligations of support, structured credit products have lost value when correlations between assets increased in stress environments, and unhedged derivatives have produced large liabilities arising from extreme low-probability market events.

15.6.2 Similarly, additional considerations need to be given for assets in which investment is permitted by the regime (because the risk is generally sufficiently assessable) but which are less transparent compared to other investments. Other assets could be less well governed in terms of the systems and controls in place for managing them or the market regulation that applies to them. Such assets may present operational risks that may arise in adverse conditions which are difficult to assess reliably. In terms of market regulation, investments in an unregulated market or a market that is subject to less regulation such as a professional securities market need to be given special consideration.

15.6.3 Supervisors should therefore establish quantitative and qualitative requirements or restrictions on such investments including those described below. As an example, where appropriate the regulatory investment requirements might include the pre-approval of an insurer's derivative investment plan e.g. a dynamic hedging program. That pre-approval procedure could require that the insurer describe its controls over the derivative investment process and the testing of the process before it is used in a live environment.

15.6.4 The investments described below do not represent an exhaustive list and regulatory investment requirements should be flexible (or sufficiently broad) to take account of the changing environment. The solvency position and the sophistication of an insurer should also be considered. The amount of available capital an insurer has could provide additional flexibility to the supervisor in particular cases.

Off-balance sheet structures

15.6.5 The supervisor should consider whether investments in off-balance sheet structures should be permitted under the regulatory investment regime or if the investment was set up in order to circumvent any regulatory investment requirements.

15.6.6 SPEs are generally set up for a specific purpose to meet specific payments to investors, who have accepted the risk profile of their payments based on the cash flows underlying the SPE. The investment strategy for the SPE may need to be more restrictive than the strategy for the insurer, which may choose to make more risky investments if it has adequate free assets.

15.6.7 The investment strategy for the structure may be different from the investment strategy for the insurer, as there may be a different appetite to take on different investment risks. However, the investment strategy adopted by the off-balance sheet structure may have an impact on the ability of the insurer to make payments to the policyholders, especially if the structure is in a stressed position.

Investments in structured credit products

15.6.8 It may also be the case that the insurer invests in securities or other financial instruments which have been "repackaged" by an SPE and which may originate from other financial institutions (including banks or insurers). Examples of such instruments are asset backed securities (ABS), credit linked notes (CLN) or insurance linked securities (ILS). In these cases, it may be very difficult for the insurer to assess the risk inherent in the investment (and in particular the risk profile of the underlying reference instruments which in some cases may be of particularly poor quality e.g. sub-prime mortgages). Where the originator is another insurer, the investment may also carry insurance related risks (such as non-life catastrophe risks in the case of a non-life catastrophe bond securitisation) which may not be transparent to the insurer or else difficult to assess.

15.6.9 In order to prevent that the insurer is exposed to an undue level of risk in such cases, the supervisor may consider establishing qualitative or quantitative requirements which may relate directly to the insurer investing in such assets, or which may relate to the originator of the "repackaged" instrument.

15.6.10 Such requirements may recognise that some structured credit products are higher risk than others and consider, for example:

- the treatment of such investment in other financial sectors;
- the extent to which the originator has retained an interest in a proportion of the risk being distributed to the market;
- the definition and soundness of criteria applied by the originator in extending the original credit and in diversifying its credit portfolio;
- the transparency of the underlying instruments; and
- the procedures the insurer has in place to monitor exposures to securitisations, including consideration of securitisation tranches, and reporting them to the insurer's Board and Senior Management and supervisor.

Restrictions or prohibition may be applied to investments in structured products where appropriate conditions are not satisfied.

Use of derivatives and similar commitments

15.6.11 A derivative is a financial asset or liability whose value depends on (or is derived from) other assets, liabilities or indices (the "underlying asset"). Derivatives are financial contracts and include a wide assortment of

instruments, such as forwards, futures, options, warrants and swaps. Similar commitments can be embedded in hybrid instruments that are not themselves derivatives (e.g. a bond whose maturity value is tied to an equity index is a hybrid instrument that contains a derivative). An insurer choosing to engage in derivative activities should clearly define its objectives, ensuring that these are consistent with any legislative restrictions.

15.6.12 Derivatives, used appropriately, can be useful tools in the management of portfolio risk of insurers and in efficient portfolio management. In monitoring the activities of insurers involved in derivatives, the supervisor satisfies itself that the insurer has the ability to recognise, measure and prudently manage the risks associated with their use. The supervisor should obtain sufficient information on the insurer's policies and procedures on the use of derivatives and may request information on the purpose for which particular derivatives are to be used and the rationale for undertaking particular transactions.

15.6.13 Given the nature of insurance operations, derivatives should preferably be used as a risk management mechanism rather than for speculative investment. Supervisors may restrict the use of derivatives (particularly derivatives that involve the possibility of unlimited commitments) to the reduction of investment risk or efficient portfolio management. This means that where derivatives are used it is required that this is for the purpose of reducing risk and costs or generating additional capital or income with an acceptable level of risk. Restrictions may also be applied to require the suitability of derivative counterparties, the cover the insurer has to meet any obligations it has under the derivative, the tradability of the derivative and, in the case of over-the-counter derivatives, the ability to value it and to close it out at that value when needed. Derivatives should be considered in the context of a prudent overall asset/liability management strategy. This should also apply to financial instruments that have the economic effect of derivatives.

ICP 16 Enterprise Risk Management for Solvency Purposes

The supervisor establishes enterprise risk management requirements for solvency purposes that require insurers to address all relevant and material risks.

Introductory Guidance

16.0.1 This ICP does not directly apply to non-insurance entities (regulated or unregulated) within an insurance group, but it does apply to insurance legal entities and insurance groups with regard to the risks posed to them by non-insurance entities.

Enterprise risk management

16.0.2 Several different terms are commonly used to describe the process of identifying, assessing, measuring, monitoring, controlling and mitigating risks. This ICP uses the generic term enterprise risk management (ERM) in describing these activities in respect of the insurance enterprise as a whole.

16.0.3 This ICP recognises the importance of an enterprise risk management framework from a supervisory perspective in underpinning robust insurance legal entity and group-wide solvency assessment.

16.0.4 The raison d'être of insurance is the assumption, pooling and spreading of risk so as to mitigate the risk of adverse financial consequences to individuals and businesses that are policyholders. For this reason, a thorough understanding of risk types, their characteristics and interdependencies, the sources of the risks and their potential impact on the business is essential for insurers. Insurers should exhibit an understanding of their enterprise risk issues and show a willingness and ability to address those issues. Supervisors should, therefore, seek to require that the insurer has a competent understanding of risk and implements sound risk management practices. The ultimate aim of insurance is to create and protect value for policyholders while using capital resources efficiently. A purpose of both risk and capital management is to protect policyholders and capital providers from adverse events. It is therefore natural for insurers to combine the management of risk and capital.

16.0.5 ERM involves the self-assessment of all reasonably foreseeable and relevant material risks that an insurer faces and their interrelationships. One outcome of ERM, which is particularly relevant for this ICP, is that decisions regarding risk management and capital allocation can be co-ordinated for maximum financial efficiency and, from a supervisory viewpoint, the adequate protection of policyholders. A fundamental aspect of ERM is a primary focus on the actions that an insurer takes to manage its risks on an ongoing basis and specific aspects of those risks, so as to ensure that they are the risks it intends to retain both individually and in aggregate and that the insurer stays within its risk tolerance. ERM

also involves the rigorous enforcement of risk standards, policies and limits.

16.0.6 ERM is an acknowledged practice and has become an established discipline and separately identified function assuming a much greater role in many insurers' everyday business practices. Originally, risk management only facilitated the identification of risks and was not fully developed to provide satisfactory methods for measuring and managing risks, or for determining related capital requirements to cover those risks. ERM processes being developed today by insurers increasingly use internal models and sophisticated risk metrics to translate risk identification into management actions and capital needs. Internal models are recognised as powerful tools that may be used, where it is appropriate to the nature, scale and complexity to do so, to enhance company risk management and to better embed risk culture in the company. They can be used to provide a common measurement basis across all risks (e.g. same methodology, time horizon, risk measure, level of confidence, etc.) and enhance strategic decision-making, for example capital allocation and pricing. Such an approach typically adopts a total balance sheet approach whereby the impact of the totality of material risks is fully recognised on an economic basis. A total balance sheet approach reflects the interdependence between assets, liabilities, capital requirements and capital resources, and identifies a capital allocation, where needed, to protect the insurer and its policyholders and to optimise returns to the insurer on its capital.

16.0.7 ERM provides a link between the ongoing operational management of risk and longer-term business goals and strategies. Appropriate risk management policies should be set by each insurer according to the nature, scale[30] and complexity of its business and the risks it bears. This ICP focuses on the link between risk management and the management of capital adequacy and solvency. Insurers should integrate their ERM framework in their overall corporate governance framework as described in ICP 8 Risk Management and Internal Controls.

16.0.8 The objective of ERM is not to eliminate risk. Rather, it is to manage risks within a framework that includes self-imposed limits. In setting limits for risk, the insurer should consider its solvency position and its risk tolerance. Limits should be set after careful consideration of corporate objectives and circumstances and, where appropriate, should take into account the projected outcomes of scenarios run using a range of plausible future business assumptions which reflect sufficiently adverse scenarios. Within these limits, risks can be reduced if this is cost effective, or increased, if justified by the expectation of enhanced returns and the availability of additional capital, without endangering the capacity of the insurer to meet its commitments to policyholders.

16.0.9 The IAIS recognises the different levels of sophistication of supervisors and insurance markets around the world and acknowledges that this ICP may not be fully achievable by some insurers and in some markets in the

[30] The scale of the business is a relevant factor. Some insurers may be less well diversified and more susceptible to risks arising from external sources. They may also need to structure their risk management functions differently from other insurers and commission external consultants to achieve satisfactory standards and robust processes; they may need to use reinsurance to a greater extent.

near future. Nevertheless, the IAIS believes that good risk management practices and procedures need to be in place for solvency requirements to be effective. ERM that follows this ICP is expected to enhance confidence in assessing an insurer's financial strength. The IAIS envisages that solvency requirements will, over time, be developed towards conformity with the ICPs. The IAIS nevertheless wishes to emphasise that this ICP does not prescribe a specific aspect of solvency requirements which is to be applied compulsorily by IAIS members.

Enterprise risk management framework - risk identification and measurement

16.1 The supervisor requires the insurer's enterprise risk management framework to provide for the identification and quantification of risk under a sufficiently wide range of outcomes using techniques which are appropriate to the nature, scale and complexity of the risks the insurer bears and adequate for risk and capital management and for solvency purposes.

Risk identification

16.1.1 The ERM framework should identify and address all reasonably foreseeable and relevant material risks to which an insurer is, or is likely to become, exposed. Such risks should include, at a minimum, underwriting risk[31], market risk, credit risk, operational risk and liquidity risk and may also include, for example, legal risk and risk to the reputation of the insurer.

16.1.2 After identification of risks, an insurer should highlight significant risks together with possible key leading indicators (e.g. a relevant stock market indicator). This information should be included in regular management information which is relevant and focussed.

Causes of risk and the relationship between risks

16.1.3 An insurer should consider the causes of different risks and their impacts and assess the relationship between risk exposures. By doing so, an insurer can better identify both strengths and weaknesses in governance, business and control functions and should use and improve risk management policies, techniques and practices and change its organisational structure to make these improvements where necessary. The insurer should also assess external risk factors which, if they were to crystallise, could pose a significant threat to its business. The insurer should recognise the limitations of the methods it uses to manage risks, the potential impact these limitations may have and adapt its risk management appropriately.

16.1.4 In assessing the relationship between risk exposures, consideration should be given to correlations between the tails of risk profiles. For example, risks that show no strong dependence under normal economic

[31] The term "underwriting risk" is used in a broad sense and includes claims, expense and reserving risks and the risks associated with guarantees and options embedded in policies.

conditions, such as catastrophe risks and market risks, could be more correlated in a stress situation.

16.1.5 As an illustration, insurers should be particularly aware that certain major trigger events, such as catastrophes, downgrades from rating agencies or other events that have an adverse impact on the insurer's reputation, can result, for example, in a high level of claims, collateral calls or policyholder terminations, especially from institutional counterparties or institutional policyholders and hence lead to serious liquidity issues. The ERM framework should adequately address the insurer's options for responding to such trigger events.

Measuring, analysing and modelling the level of risk

16.1.6 The level of risk is a combination of the impact that the risk will have on the insurer and the probability of that risk materialising. The level of risk borne by the insurer should be assessed regularly using appropriate forward-looking quantitative techniques such as risk modelling,[32] stress testing, including reverse stress testing, and scenario analysis. An appropriate range of adverse circumstances and events should be considered, including those that pose a significant threat to the financial condition of the insurer, and management actions should be identified together with the appropriate timing of those actions. Risk measurement techniques should also be used in developing long-term business and contingency plans, where it is appropriate to the nature, scale and complexity to do so.

16.1.7 Different approaches may be appropriate depending on the nature, scale and complexity of a risk and the availability of reliable data on the behaviour of that risk. For example, a low frequency but high impact risk where there is limited data, such as catastrophe risk, may require a different approach from a high frequency, low impact risk for which there is substantial amounts of experience data available. Stochastic risk modelling may be appropriate to measure some non-life catastrophe risks for example, whereas relative simple calculations may be appropriate in other circumstances.

16.1.8 The measurement of risks should be based on a consistent economic assessment of the total balance sheet as appropriate to ensure that appropriate risk management actions are taken. In principle, ERM should take into consideration the distribution of future cash flows to measure the level of risks. Care should be taken not to base ERM decisions purely on accounting or regulatory measures that involve non-economic considerations and conventions although the constraints on cash flows that they represent should be taken into account.

16.1.9 The quantitative assessment of risks the insurer faces provides it with a disciplined method of monitoring risk exposure. Assessments undertaken at different times should be produced on a broadly consistent basis overall, so that any variations in results can be readily explained. Such analysis also aids an insurer in prioritising its risk management.

[32] "Modelling" in this context does not necessarily mean complex stochastic modelling. It can also include less sophisticated methods.

16.1.10 Where models are used, it must be remembered that, regardless of how sophisticated they are, they cannot exactly replicate the real world. As such, the use of models itself generates risk (modelling and parameter risk) which, if not explicitly quantified, at least needs to be acknowledged and understood as the insurer implements its ERM framework, including by the insurer's Board and Senior Management.

16.1.11 Models may be external or internal. External models may be used to assess external insurance or market risks while internal models may be developed by an insurer to assess specific material risks or to assess its risks overall where this cannot be done appropriately by external models.

16.1.12 Internal models can play an important role in facilitating the risk management process and supervisors should encourage insurers to make use of such models for parts or all of their business where it is appropriate to the nature, scale and complexity to do so. Further guidance on the use of internal models for the insurers own risk and solvency assessment is contained in Guidance 16.14.11 - 16.14.19.

16.1.13 Where a risk is not readily quantifiable, for instance some operational risks or where there is an impact on the insurer's reputation, an insurer should make a qualitative assessment that is appropriate to that risk and sufficiently detailed to be useful for risk management. An insurer should analyse the controls needed to manage such risks to ensure that its risk assessments are reliable and consider events that may result in high operational costs or operational failure. Such analysis is expected to inform an insurer's judgments in assessing the size of the risks and enhancing overall risk management.

16.1.14 Stress testing measures the financial impact of stressing one or relatively few factors affecting the insurer. Scenario analysis considers the impact of a combination of circumstances which may reflect extreme historical scenarios which are analysed in the light of current conditions. Scenario analysis may be conducted deterministically using a range of specified scenarios or stochastically, using models to simulate many possible scenarios, to derive statistical distributions of the results.

16.1.15 Stress testing and scenario analysis should be carried out by the insurer to validate and understand the limitations of its models. They may also be used to complement the use of models for risks that are difficult to model, or where the use of a model may not be appropriate from a cost-benefit perspective. This may arise, for example, where a range of calculations is urgently required focusing on specific aspects or going beyond the current parameters of the model to investigate the effect of proposed management actions.

16.1.16 Scenario analysis may be particularly useful as an aid to communication in relation to risk management between the Board and Senior Management and other parts of the organisation thereby facilitating the integration of the insurer's ERM framework with its business operations and culture.

16.1.17 Reverse stress testing, which identifies scenarios that are most likely to cause an insurer to fail, may also be used to enhance risk management. While some risk of failure is always present, such an approach may help to ensure adequate focus on the management actions that are

appropriate to avoid undue risk of business failure. The focus of such reverse stress testing is on appropriate risk management actions rather than the assessment of financial adequacy and so may be largely qualitative in nature although broad assessment of associated financial impacts may help in deciding the appropriate action to take.

Additional guidance for insurance groups and insurance legal entities that are members of groups

16.1.18 "Group risk" arises for insurance legal entities that are members of groups. Group risk also arises for an insurance group in respect of the widest group of which it is part. Group risk includes the risk that an insurance legal entity may be adversely affected by an occurrence (financial or non-financial) in another group entity. For instance, losses in one group member may create pressure to divert the financial resources of other members of the group to that entity or otherwise lead to a depletion of those financial resources. Group risk also includes the risk that the financial stability of a group or insurance legal entities within the group may be adversely affected by an event in a legal entity, a group-wide occurrence or an event external to the group. For example, the positive aspects of being a member of a group might be lessened due to restructuring.

16.1.19 Group risk may arise, for example, through contagion, leveraging, double or multiple gearing, concentrations, large exposures and complexity. Participations, loans, guarantees, risk transfers, liquidity, outsourcing arrangements and off-balance sheet exposures may all give rise to group risk. Many of these risks may be borne by stand-alone insurance legal entities and are not specific to membership of a group. However, the inter-relationships among group members including aspects of control, influence and interdependence alter the impact of risks on group members and should therefore be taken into account in managing the risks of an insurance legal entity that is a member of an insurance group and in managing the risks of that insurance group as a whole. To be effective, the management of insurance group risk needs to take into account risks arising from all parts of an insurance group including non-insurance entities (regulated or unregulated) and partly-owned entities.

16.1.20 The risks identified and the techniques that are appropriate and adequate for measuring them, including stress testing, scenario analysis, risk modelling and reverse stress testing, may differ at insurance group and insurance legal entity level. Where an insurance legal entity's ERM framework is an integral part of the insurance group's ERM framework, the techniques used to measure risks at insurance legal entity level should include those that are appropriate and adequate at the insurance legal entity level in order to meet the insurance legal entity's ERM requirements.

16.1.21 The ERM of an insurance group should address the direct and indirect interrelationships between its members. The more clearly-defined and understood such relationships are, the more accurately they can be allowed for in the group-wide solvency assessment. For example, legally enforceable capital and risk transfer instruments (CTRI) established between insurance group members may help to establish the integrity of

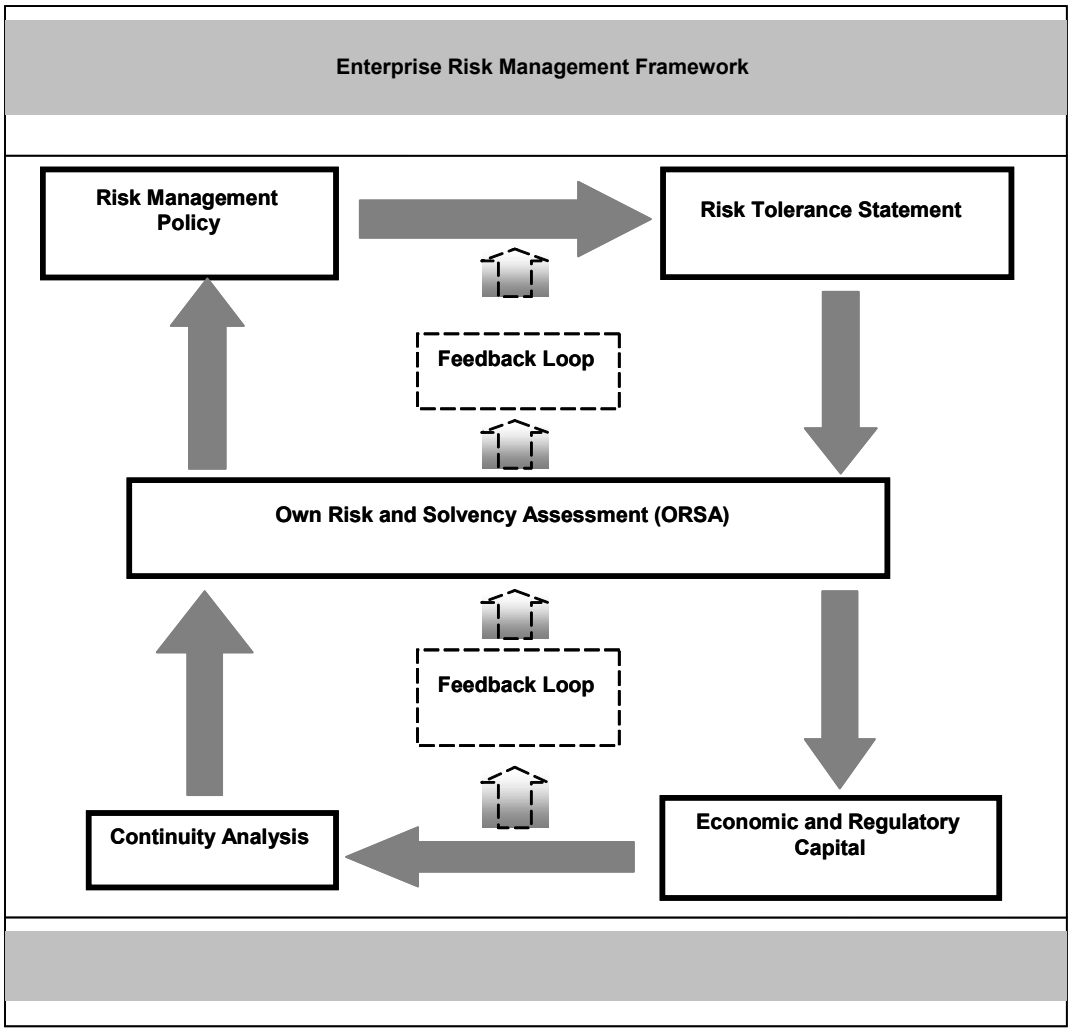
the insurance group and the effectiveness of its ERM framework for group-wide solvency assessment purposes.

16.1.22 Assumptions that are implicit in the solvency assessment of an insurance legal entity may not apply at an insurance group level because of the legal separation of insurance group members. For example, there may be few constraints on the fungibility of capital and the transferability of assets within an individual insurance legal entity. An assumption of full fungibility may be appropriate for such an insurer.[33] However, such constraints may feature much more prominently for an insurance group and may, for example, restrict the degree to which benefits of diversification of risks across the group can be shared among group members. Such constraints should be taken into account in both the insurance group's and the insurance legal entity's ERM frameworks.

16.1.23 The following diagram Figure 16.1 illustrates the IAIS standard ERM framework showing the key features of the framework as described in the following sections of this ICP.

[33] This assumption may not always be appropriate for an insurance legal entity e.g. if it has branches in different jurisdictions where restrictions on fungibility of capital apply or where there is ring-fencing of with-profit funds.

Figure 16.1 The IAIS standard ERM framework



Enterprise risk management framework - documentation

16.2 The supervisor requires the insurer's measurement of risk to be supported by accurate documentation providing appropriately detailed descriptions and explanations of the risks covered, the measurement approaches used and the key assumptions made.

Enterprise risk management framework - risk management policy

16.3 The supervisor requires the insurer to have a risk management policy which outlines how all relevant and material categories of risk are managed, both in the insurer's business strategy and its day-to-day operations.

16.3.1 As part of the required ERM framework, an insurer should describe its policy for managing the risks to which it is exposed, including the processes and methods for monitoring risk. A risk management policy would be expected to include a description of the insurer's policies towards risk retention, risk management strategies including reinsurance

and the use of derivatives, diversification/ specialisation and asset-liability management (ALM).

16.3.2 An insurer's risk management policy should clearly address the relationship between pricing, product development and investment management in order that product design and pricing and the accompanying investment strategy are appropriately aligned. In particular, investment and product benchmarks may need to be established to require that the insurer's financial objectives continue to be met.

Additional guidance for insurance groups and insurance legal entities that are members of groups

16.3.3 An insurance group should have a risk management policy which outlines the way in which it manages all the risks that are relevant and material at insurance group level, both in its business strategy and its day-to-day operations. This includes group risk that arises from the insurance group being part of a wider group.

16.3.4 The categories of risks covered by the insurance legal entity's risk management policy should include the category comprising all of the additional group risks it faces as a result of its membership of a group. Such risks may arise from the widest group of which the insurance legal entity is a member and not only from its insurance group.

16.3.5 Where an insurance legal entity's risk management policy is an integral part of an insurance group's risk management policy, it is the responsibility of the Board and Senior Management of the insurance legal entity to make sure that the insurance legal entity's risk management policy covers all the risks that are relevant and material at insurance legal entity level and that this policy is clearly defined and understood.

16.4 The supervisor requires the insurer to have a risk management policy which describes the relationship between the insurer's tolerance limits, regulatory capital requirements, economic capital and the processes and methods for monitoring risk.

16.4.1 An insurer's risk management policy should describe how its risk management links with its management of capital (regulatory capital requirement and economic capital).

16.4.2 As an integral part of its risk management policy, an insurer should also describe how its risk management links with corporate objectives, strategy and current circumstances. A reasonably long time horizon, consistent with the nature of the insurer's risks and the business planning horizon, should be considered by the risk management policy so that it maintains relevance to the insurer's business going forward. This can be done by using methods, such as scenario models, that produce a range of outcomes based on plausible future business assumptions which reflect sufficiently adverse scenarios. The insurer should monitor risks so that the Board and Senior Management are fully aware of the insurer's risk profile and how it is evolving. Where models are used for business forecasting insurers should perform back-testing, to the extent practicable, to validate the accuracy of the model over time.

16.4.3 As part of its risk mitigation strategy, an insurer may transfer some of the risk on its own balance sheet to an off-balance sheet structure, such as a special purpose entity (SPE). SPEs are generally set up for a specific purpose to meet specific payments to investors, who have accepted the risk profile of their payments based on the cash flows underlying the SPE. The risk remaining with the insurer as a result of the off-balance sheet structure should be managed effectively. For an SPE these may arise as follows:

- Even though the SPE's cash flows are not part of the insurer's balance sheet, the insurer may still face pressure to support the payments out of the SPE during periods of stress, due to reputational damage to the insurer if the payments to the investors are not made.
- Default by an SPE may cause the insurer reputational damage and affect its ability to raise finance in the future, possibly leading to liquidity issues. In addition, default by an SPE may have implications on the insurer's credit rating, which may further affect the insurer's ability to raise finance in the future.
- The investment policy of the SPE, including that for assets transferred from the insurer, may differ from the investment policy of the insurer because of differences in capital and risk tolerance. However, the investment strategy adopted by the SPE may have an impact on the insurer's ability to make payments to the policyholders, especially if the SPE is in a stressed position.

16.5 The supervisor requires the insurer to have a risk management policy which includes an explicit asset-liability management (ALM) policy which clearly specifies the nature, role and extent of ALM activities and their relationship with product development, pricing functions and investment management.

16.5.1 ALM is the practice of managing a business so that decisions and actions taken with respect to assets and liabilities are coordinated. To co-ordinate the management of risks associated with assets and liabilities, the insurer's risk management policy should include an explicit ALM policy which is appropriate to the nature, scale and complexity of those risks to set out how the investment and liability strategies adopted by the insurer allow for the interaction between assets and liabilities, how the liability cash flows will be met by the cash inflows and how the economic valuation of assets and liabilities will change under an appropriate range of different scenarios. ALM does not imply that assets should be matched as closely as possible to liabilities but that mismatches are effectively managed. Not all ALM needs to use complex techniques. For example, simple, low risk or short term business may call for less complex ALM techniques.

16.5.2 The ALM policy should recognise the interdependence between all of the insurer's assets and liabilities and take into account the correlation of risk between different asset classes as well as the correlations between different products and business lines, recognising that correlations may not be linear. The ALM framework should also take into account any off-

balance sheet exposures that the insurer may have and the contingency that risks transferred may revert to the insurer.

16.5.3 Different strategies may be appropriate for different categories of assets and liabilities. One possible approach to ALM is to identify separate homogeneous segments of liabilities and obtain investments for each segment which would be appropriate if each liability segment was a stand-alone business. Another possible approach is to manage the insurer's assets and liabilities together as a whole. The latter approach may provide greater opportunities for profit and management of risk than the former. If ALM is practised for each business segment separately, this is likely to mean that the benefits of scale, hedging, diversification and reinsurance that can be gained from managing the different segments of assets and liabilities together are ignored or receive less attention.

16.5.4 However, for some types of insurance business it may not be appropriate to manage risks by combining liability segments. It may be necessary for the insurer to devise separate and self-contained ALM policies for particular portfolios of assets that are "ring-fenced" or otherwise not freely available to cover obligations in other parts of the company.

16.5.5 Assets and liabilities may be ring-fenced to protect policyholders. For example, non-life insurance business is normally ring-fenced from life insurance business and a separate fund of assets may be used to determine the benefits under participating business. Some assets may be required by regulation or the insurer's risk management policy to be closely matched with corresponding liabilities, for example equity-linked or indexed-linked benefits may be closely matched with corresponding assets, and annuities cash outflows may be closely matched with cash inflows from fixed income instruments.

16.5.6 Some liabilities may have particularly long durations, such as certain types of liability insurance and whole-life policies and annuities. In these cases, assets with sufficiently long duration may not be available to match the liabilities, introducing a significant reinvestment risk, such that the present value of future net liability cash flows is particularly sensitive to changes in interest rates. Many financial markets throughout the world do not have long fixed-income assets to back long duration liabilities. There may also be gaps in the asset durations available. This may be an issue even in the most well developed markets for some types of liabilities. Risks arising from mismatches between assets and liabilities require particular attention. The insurer should give explicit attention within its ALM policy to risks arising from liabilities with substantially longer durations or other mismatches with assets available from the corresponding financial markets to ensure that they are effectively managed by holding adequate capital or having appropriate risk mitigation in place.

16.6 The supervisor requires the insurer to have a risk management policy which is reflected in an explicit investment policy which:

- **specifies the nature, role and extent of the insurer's investment activities and how the insurer complies with the regulatory investment requirements established by the supervisor; and**

- **establishes explicit risk management procedures within its investment policy with regard to more complex and less transparent classes of asset and investment in markets or instruments that are subject to less governance or regulation.**

16.6.1 The insurer's risk management policy should be reflected in an explicit investment policy. Such a policy may, for example, set out the insurer's strategy for optimising investment returns and specify asset allocation strategies and authorities for investment activities and how these are related to the ALM policy. It may also specify how regulatory investment requirements (see ICP 15 Investment) and other parameters are met.

16.6.2 The insurer's investment policy should outline its policy towards inherently risky financial instruments such as derivatives of various types, hybrid instruments that embed derivatives, private equity, alternative investment funds such as hedge funds, insurance linked instruments and commitments transacted through special purpose entities. Consideration of the associated counterparty credit risk should be included in the investment policy. It should also set out the policy for the safe-keeping of assets including custodial arrangements and the conditions under which investments may be pledged or lent.

16.6.3 Similarly, explicit consideration should be given by the insurer to assets for which the risk is generally sufficiently assessable to be permitted by the supervisor but, compared to other investments, are more complex, less transparent, less well regulated in terms of the market regulation that applies to them or less well governed in terms of the processes required to manage them. Such assets may present operational risks in adverse conditions which are difficult to assess reliably. In terms of market regulation, investments in an unregulated market or a market that is subject to less governance such as a professional securities market and investments that are not traded on a public exchange need to be given special consideration.

16.6.4 For investment risks in particular, it is important for the insurer to understand the source, type and amount of risk that it is accepting across all lines of business. For example, where there is a complex chain of transactions it should understand who has the ultimate legal risk or basis risk. Similar questions arise where the investment is via external funds, especially when such funds are not transparent.

16.6.5 For insurers in many jurisdictions concentration risk arising from the limited availability of suitable domestic investment vehicles is an issue. By contrast, international insurers' investment strategies may be complex because of a need to manage and match assets and liabilities in a number of currencies and different markets. In addition, the need for liquidity resulting from potential large-scale payments may further complicate an insurer's investment strategy.

16.6.6 The insurer should have the competencies necessary to manage the instruments it is investing in. For complex investment activities (including underwriting guarantees for such complex securities) robust models of risks that consider all relevant variables may be needed. It is the insurer's responsibility to ensure that the internal expertise and competence necessary are in place at all levels of the organisation to manage these

risks effectively including the expertise to apply and vet any models used and to assess them against market convention. Also, an insurer needs explicit procedures to evaluate hidden and non-standard risks associated with complex structured products, especially new forms of concentration risk that may not be obvious.

16.6.7 For complex investment strategies, aspects to consider include liquidity and responsiveness to sudden market movements. Stress testing, as well as contingency planning for stressed situations, is essential. Trial operation of procedures for sufficiently long periods may also be appropriate in advance of 'live' operation.

16.6.8 For derivatives, for example, there is a wide variation of products. There are also hybrid instruments that embed derivatives such as bonds whose maturity values are tied to an equity index. The insurer's risk management policy should be clear about the purpose of using derivatives and address whether it is appropriate for it to rule out or restrict the use of some types of derivatives where, for example:

- the potential exposure cannot be reliably measured;
- closing out of a derivative is difficult considering the illiquidity of the market;
- the derivative is not readily marketable as may be the case with over-the-counter instruments;
- independent (i.e. external) verification of pricing is not available;
- collateral arrangements do not fully cover the exposure to the counterparty;
- the counterparty is not suitably creditworthy; and
- the exposure to any one counterparty exceeds a specified amount

These factors are particularly important for "over-the-counter" derivatives which are not effected or issued on or under the rules of a regulated market. The effectiveness of clearing facilities available may be a relevant consideration in assessing the counterparty risk associated with some types of widely traded "over-the-counter" derivatives, such as credit default swaps.

16.7 The supervisor requires the insurer to have a risk management policy which includes explicit policies in relation to underwriting risk.

16.7.1 The risk management policy should also include explicit policies in relation to underwriting risk i.e. the specific insurance risk arising from the underwriting of insurance contracts. Such policies may relate to the underwriting process, pricing, claims settlement both in terms of timing and amount and expense control aspects of managing the risks arising from the insurance contracts the insurer writes. Such policies may include, for example, the terms on which contracts are written and any exclusions, the procedures and conditions that need to be satisfied for risks to be accepted, additional premiums for substandard risks and procedures and conditions that need to be satisfied for claims to be paid.

16.7.2 ALM may be needed to address parts of underwriting risk. The uncertainty of timing and size of future claim payments, especially for long-tail non-life business, may require coordination with the management of assets under the ALM policy.

16.7.3 The insurer should ensure that the underwriting policy pays particular attention to risk retention and risk transfer through reinsurance and other forms of risk transfer as appropriate to the insurer's risk profile and capital. The policy should take account of the effectiveness of risk transfer in adverse circumstances.

16.7.4 Expense control is an important part of managing risk especially in conditions of high general rates of inflation. Inflation of claim amounts also tends to be high in such conditions for some types of risk. Insurers should therefore have systems in place to control their expenses, including claims handling and administration expenses. These expenses should be monitored by management on an on-going basis.

16.7.5 Reinsurance arrangements should be adequate and the claims by the insurer on its reinsurers should be recoverable. This includes ensuring that:

- the insurer's reinsurance programme provides coverage appropriate to its level of capital, the profile of the risks it underwrites, its business strategy and risk tolerance;
- the protection provided by the reinsurer is secure. This might be addressed by the insurer by ensuring that the financial strength of the reinsurer is adequate, obtaining collateral (including trusts, letters of credit or funds withheld[34]), limiting exposure to particular reinsurers or holding adequate capital to cover exposure to the risk of reinsurer default. Insurers should perform their own assessment of the financial strength of reinsurers and be careful not to place undue emphasis on external ratings; and
- the effectiveness of the transfer of risk should be assessed for particular risk transfer arrangements to ensure that risk will not revert to the insurer in adverse circumstances. The insurer should review its arrangements if there is a possibility that it will provide support to the reinsurer in such circumstances.

Enterprise risk management framework - risk tolerance statement

16.8 The supervisor requires the insurer to:

- **establish and maintain a risk tolerance statement which sets out its overall quantitative and qualitative risk tolerance levels and defines risk**

[34] Funds withheld: the capital which achieves both the objectives of reducing the probability of insolvency by absorbing losses on a going-concern basis, or in run-off, and of reducing the loss to policyholders in the event of insolvency or winding-up.

tolerance limits which take into account all relevant and material categories of risk and the relationships between them;

- **make use of its risk tolerance levels in its business strategy; and**
- **embed its defined risk tolerance limits in its day-to-day operations via its risk management policies and procedures.**

16.8.1 In parallel with developing its risk management policy, establishing appropriate tools for analysing, assessing, monitoring and measuring risks and identifying its risk exposures, an insurer should establish and maintain a risk tolerance statement. An insurer's overall risk tolerance statement should set out the level of risk to which it is willing and able to be exposed, taking into account its financial strength and the nature, scale and complexity of its business and risks, the liquidity and transferability of its business and the physical resources it needs to adequately manage its risks.

16.8.2 The risk tolerance statement should define the insurer's 'tolerance limits' which give clear guidance to operational management on the level of risk to which the insurer is prepared to be exposed and the limits of risk to which they are able to expose the insurer as part of their work. An insurer should consider how these tolerance limits are to be suitably embedded in its ongoing operational processes. This can be achieved, for instance, by expressing tolerance limits in a way that can be measured and monitored as part of ongoing operations. Stress testing can also provide an insurer with a tool to help ascertain whether its tolerance limits remain suitable for its business.

Additional guidance for insurance groups and insurance legal entities that are members of groups

16.8.3 An insurance group should establish and maintain a risk tolerance statement based on its strategy which sets out its overall quantitative and qualitative tolerance levels and defines tolerance limits which take into account all categories of risk which are relevant and material to the insurance group and the relationships between them. The insurance group's risk tolerance levels should be actively applied within its ERM framework and risk management policy.

An insurance legal entity's risk tolerance statement should define tolerance limits taking into account the category of risks comprising all of the group risks it faces as a result of membership of a group to the extent that they are relevant and material to the insurance legal entity.

16.8.4 Insurance group tolerance limits should give the Board and Senior Management of a member insurance legal entity clear guidance on the level of risk which the insurance group is prepared to take and the limits to which the insurance legal entity is able to expose the insurance group during the course of its business. It is the responsibility of the Board and Senior Management of the insurance legal entity to make sure that their group environment is clearly defined and understood.

Enterprise risk management framework - risk responsiveness and feedback loop

16.9 The supervisor requires the insurer's ERM framework to be responsive to changes in its risk profile.

16.9.1 The ERM framework and risk management policy of the insurer should be responsive to change as a result of both internal and external events. The framework should include mechanisms to incorporate new risks and new information on a regular basis. For example, new risks identified from within the business may include new acquisitions, investment positions, or business lines. New information may become available from external sources, as a result of evolution of the environment affecting the nature and size of underlying risks. Supervisory and legislative requirements, rating agency concerns (if applicable), political changes, major catastrophes or market turbulence may all make changes necessary. The framework and policy should also be responsive to the changing interests and reasonable expectations of policyholders and other stakeholders.

16.10 The supervisor requires the insurer's ERM framework to incorporate a feedback loop, based on appropriate and good quality information, management processes and objective assessment, which enables it to take the necessary action in a timely manner in response to changes in its risk profile.

16.10.1 Within the ERM framework there should also be a "feedback loop". This should ensure that decisions made by the Board and Senior Management are implemented and their effects monitored and reported in a timely and sufficiently frequent manner via good management information. The feedback loop is the process of assessing the effect, within the ERM framework, of changes in risk leading to changes in risk management policy, tolerance limits and risk mitigating actions. Without this continual updating process, complemented by explicit one-off changes in response to major events, the ERM framework would not remain relevant in assisting the insurer in meeting its strategic and risk objectives.

Additional guidance for insurance groups and insurance legal entities that are members of groups

16.10.2 An insurance group's ERM framework should incorporate a feedback loop, based on appropriate and good quality information, management processes and objective assessment, which enables it to take the necessary action in a timely manner in response to changes in its risk profile.

16.10.3 Group risk should be included in the feedback loop of the insurance legal entity's ERM framework in respect of the widest group of which it is a member. This means the insurance legal entity should obtain appropriate and good quality information about changes in the group which affect its risk profile. It also means the management of the insurance legal entity should provide information to an insurance group of which it is a member as part of the feedback loop of the insurance group's ERM framework.

Own risk and solvency assessment (ORSA)

16.11 The supervisor requires the insurer to perform its own risk and solvency assessment (ORSA) regularly to assess the adequacy of its risk management and current, and likely future, solvency position.

16.11.1 Every insurer should undertake its own risk and solvency assessment (ORSA) and document the rationale, calculations and action plans arising from this assessment. The ability of an insurer to reflect risks in a robust manner in its own assessment of risk and solvency is supported by an effective overall ERM framework and by embedding its risk management policy in its operations. It is recognised that the nature of the assessment undertaken by a particular insurer should be appropriate to the nature, scale and complexity of its risks.

16.12 The supervisor requires the insurer's Board and Senior Management to be responsible for the ORSA.

16.12.1 The prime purpose of the ORSA is to assess whether its risk management and solvency position is currently adequate and is likely to remain so in the future. Responsibility for the ORSA rests at the top level of the insurer's organisation, the insurer's Board and Senior Management. Where it is appropriate to the nature, scale and complexity to do so, the effectiveness of the ORSA should be assured through internal or external independent overall review by a suitably experienced individual, such as a Chief Risk Officer, who reports directly to or is a member of the Board.

16.13 The supervisor requires the insurer's ORSA to encompass all reasonably foreseeable and relevant material risks including, as a minimum, underwriting, credit, market, operational and liquidity risks and additional risks arising due to membership of a group. The assessment is required to identify the relationship between risk management and the level and quality of financial resources needed and available.

16.13.1 In its ORSA, an insurer should consider all material risks that may have an impact on its ability to meet its obligations to policyholders, including in that assessment a consideration of the impact of future changes in economic conditions or other external factors. An insurer should undertake an ORSA on a regular basis so that it continues to provide relevant information for its management and decision making processes. The insurer should regularly reassess the causes of risk and the extent to which particular risks are material. Significant changes in the risk profile of the insurer should prompt it to undertake a new ORSA. Risk assessment should be done in conjunction with consideration of the effectiveness of applicable controls to mitigate the risks.

Additional guidance for insurance groups and insurance legal entities that are members of groups

16.13.2 Adequate risk management should be in place within an insurance group and should be assessed on an insurance group-wide basis to enhance the assessment of insurance legal entities that are members of the group.

16.13.3 An insurance group should perform its ORSA to assess the adequacy of the group's risk management and current, and likely future, solvency position. The nature of the assessment should be appropriate to the nature, scale and complexity of the risks at insurance group level. The risks should include all reasonably foreseeable and relevant material risks arising from every member of the insurance group and from the widest group of which the insurance group is part. The insurance group's ORSA

should make sure that there are no material risks of the group that are not captured, that the fungibility of capital and the transferability of assets within the group is taken into account and that capital is not double counted. It is likely to be appropriate to the nature, scale and complexity of their risks for particular care to be given to these aspects for large complex groups.

16.13.4 Similarly, the insurance legal entity's ORSA should include all additional risks arising due to membership of the widest group of which it is a part to the extent that they impact the insurance legal entity as appropriate to the nature, scale and complexity of those risks.

16.13.5 In both the insurance legal entity's ORSA and the insurance group's ORSA, it may be appropriate to consider scenarios in which a group splits or changes its structure in other ways. Assessment of current capital adequacy and continuity analysis should include consideration of relevant possible changes in group structure and integrity in adverse circumstances and the implications this could have for group risks, the existence of the group and the support or demands from the group to or on its members.

16.13.6 Given the level of complexity at insurance group level compared with that at a legal entity level, additional analysis and information is likely to be needed in order to comprehensively address the range of insurance group level risks. It may, for example, be appropriate to apply a contagion test e.g. by using stress testing to assess the impact of difficulties in each legal entity which is a member of the insurance group on the other insurance group entities.

Own risk and solvency assessment (ORSA) - economic and regulatory capital

16.14 The supervisor requires the insurer to:

- **determine, as part of its ORSA, the overall financial resources it needs to manage its business given its own risk tolerance and business plans, and to demonstrate that supervisory requirements are met;**
- **base its risk management actions on consideration of its economic capital, regulatory capital requirements and financial resources, including its ORSA; and**
- **assess the quality and adequacy of its capital resources to meet regulatory capital requirements and any additional capital needs.**

16.14.1 In the context of its overall ERM framework, an insurer should perform its ORSA and have risk and capital management processes in place to monitor the level of its financial resources relative to its economic capital and the regulatory capital requirements set by the supervisor.

16.14.2 In the context of its own assessment, an insurer should clearly distinguish between current capital needs and its projected future financial position, having regard for its longer-term business strategy and, in particular, new business plans.

16.14.3 While holding capital is not necessarily the most effective way of managing risk, it is important that an insurer has regard for how risk management and capital management relate to and interact with each

other. Therefore, an insurer should determine the overall financial resources it needs, taking into account its risk tolerance and business plans, based on an assessment of its risks, the relationship between them and the risk mitigation in place. Determining economic capital helps an insurer to assess how best to optimise its capital base, whether to retain or transfer risk and how to allow for risks in its pricing. It also helps to give the supervisor confidence that risks are being well managed.

16.14.4 Although the amounts of economic capital and regulatory capital requirements and the methods used to determine them may differ, an insurer should be aware of, and be able to analyse and explain, these differences. Such analysis helps to embed supervisory requirements into an insurer's ORSA and risk and capital management, so as to ensure that obligations to policyholders continue to be met as they fall due.

16.14.5 As part of the ORSA, the insurer should perform its own assessment of the quality and adequacy of capital resources both in the context of determining its economic capital and in demonstrating that regulatory capital requirements are met having regard to the quality criteria established by the supervisor and other factors which the insurer considers relevant. The scope of this assessment should be appropriate to the nature, scale and complexity of the insurer's risks. The insurer should also assess the appropriateness of its capital resources in supporting its business strategy and enabling it to continue its operations, with due regard for its longer term business strategy and in particular new business plans.

Re-capitalisation

16.14.6 If an insurer suffers losses that are absorbed by its available capital resources, it may need to raise new capital to meet ongoing regulatory capital requirements and to maintain its business strategies. It cannot be assumed that capital will be readily available at the time it is needed. Therefore, an insurer's own assessment of the quality of capital should also consider the issue of re-capitalisation, especially the ability of capital to absorb losses on a going-concern basis and the extent to which the capital instruments or structures that the insurer uses may facilitate or hinder future re-capitalisation. For example, if an insurer enters into a funding arrangement where future profits are cashed immediately, the reduced future earnings potential of the insurer may make it more difficult to raise capital resources in the future.

16.14.7 For an insurer to be able to recapitalise in times of financial stress, it is critical to maintain market confidence at all times, through its solvency and capital management, investor relationships, robust governance structure/practices and fair market conduct practices. For example, where an insurer issues preferred stock without voting rights, this may affect the robustness of the governance structure and practice of that insurer. The voting rights attached to common stock can provide an important source of market discipline over an insurer's management. Other insurers may issue capital instruments with lower coupons and fees, sacrificing the economic value of the existing shareholders and bondholders.

16.14.8 When market conditions are good, many insurers should be readily able to issue sufficient volumes of high quality capital instruments at reasonable levels of cost. However, when market conditions are stressed, it is likely that only well capitalised insurers, in terms of both the quality and quantity of capital resources held, will be able to issue high quality capital instruments. Other insurers may only be able to issue limited amounts of lower quality capital and at higher cost. Therefore, supervisors should make sure that insurers have regard for such variations in market conditions and manage the quality and quantity of their capital resources in a forward looking manner. In this regard, it is expected that high quality capital instruments, such as common shares, should form the substantial part of capital resources in normal market conditions as that would enable insurers to issue capital instruments even in stressed situations. Such capital management approaches also help to address the procyclicality issues that may arise, particularly in risk-based solvency requirements.

Additional guidance for insurance groups and insurance legal entities that are members of groups

16.14.9 An insurance group should determine, as part of its ORSA, the overall financial resources it needs to manage its business given its own risk tolerance and business plans and demonstrate that its supervisory requirements are met. The insurance group's risk management actions should be based on consideration of its economic capital, regulatory capital requirements and financial resources. Economic capital should thus be determined by the insurance group as well as a member insurance legal entity and appropriate risk tolerances and management actions should be identified for both the insurance group and the insurance legal entity.

16.14.10 Key group-wide factors to be addressed in the insurer's assessment of group-wide capital resources include multiple gearing, intra-group creation of capital and reciprocal financing, leverage of the quality of capital and fungibility of capital and free transferability of assets across group entities.

Own risk and solvency assessment (ORSA) – using internal models

16.14.11 An insurer may consider that the assessment of current financial resources and the calculation of regulatory capital requirements would be better achieved through the use of internal models.

16.14.12 Where an internal model is used for the ORSA, it is likely to be an important strategic and operational decision-making tool and to be most useful if it enables the insurer to integrate its risk and capital management processes; that is, assisting with both the assessment of the risks faced within its business and the determination of the economic capital needed, where appropriate, to meet those risks.

16.14.13 An ERM framework should address all reasonably foreseeable and relevant material risks the insurer faces in accordance with a properly constructed risk management policy. To be most effective, therefore, an internal model used for the ORSA needs to address all those identified

risks and assess their impact on the insurer's business given the possible situations that could occur. The risks to be considered should include underwriting risk, credit risk, market risk, operational risk and liquidity risk (including any significant risk concentrations). The categories of risks considered should be clearly defined. The methods by which this analysis could be conducted range from simple stress testing of events to more complex stochastic modelling as appropriate to the nature, scale and complexity of the risks concerned.

16.14.14 When used for the ORSA, the insurer's internal model is likely to be calibrated on the basis of defined modelling criteria which the insurer believes will determine the level of capital appropriate and sufficient to meet its business plan and strategic objectives. These modelling criteria are likely to include the basis for valuation of the assets and liabilities, and the confidence level, risk measure and time horizon which the insurer considers appropriate to its risk tolerance and business plans. An insurer is likely to consider various factors in order to determine the modelling criteria used to determine its economic capital; for example choosing a level to achieve a certain investment rating, or to meet other business objectives.

16.14.15 In constructing its internal model for the ORSA, an insurer is likely to adopt risk modelling techniques and approaches appropriate to the nature, scale and complexity of the risks incorporated within its risk strategy and business objectives. An insurer may consider various inputs to the modelling process, such as economic scenarios, asset portfolios and liabilities from in-force or past business[35]. It is likely that the modelling criteria and the various inputs to the modelling would be established in the context of the insurer continuing to operate on a going concern basis (unless the insurer is in financial difficulty).

16.14.16 An internal model used in the ORSA to determine the economic capital enables the insurer to allocate sufficient financial resources to ensure it can continue to meet its policyholder liabilities as they fall due, at a confidence level appropriate to its business objectives. To fully assess policyholder liabilities in this way, all liabilities that need to be met to avoid putting policyholder interests at risk need to be considered, including any liabilities for which a default in payment could trigger the winding up of the insurer.

16.14.17 An internal model used by an insurer in the context of its ORSA for determining its own economic capital needs should not need supervisory approval for that purpose. However, an insurer would be expected to review its own internal model and validate it so as to satisfy itself of the appropriateness of the model for use as part of its risk and capital management processes.[36] It would be expected to calibrate the model according to its own modelling criteria. As well as internal review, the

[35] It may also consider regulatory constraints on the application and transfer of assets, e.g. in jurisdictions where insurers are required to segregate the assets backing the liabilities of different classes of insurance into separate funds and where the transfer of assets between funds is restricted by regulations.

[36] Where appropriate, taking into account the insurer's nature, scale and complexity, validation would be expected to be carried out by a different department or persons than those who created the internal model, in order to facilitate independence.

insurer may wish to consider an external review of its internal model by appropriate specialists e.g. if the internal review does not have an appropriate level of independence or the insurer's management wishes to have greater assurance about the validity of the model than can be provided by an internal review.

Additional guidance for insurance groups and insurance legal entities that are members of groups on using an internal model for the ORSA

16.14.18 An insurance group may consider that the assessment of financial resources and the calculation of regulatory capital requirements would be better achieved through the use of internal models to enable the range of risks and their scale and complexity to be effectively assessed.

16.14.19 All insurance legal entities and insurance groups of which they are members should be undertaking their ORSA. To carry out its ORSA, an insurance group should apply a methodology that is best suited to the nature, scale and complexity of the risk profile of its business. Although this does not necessarily imply the use of internal models for this purpose, the nature of the risks may be more diverse and the scale and complexity of the business and risks of an insurance group may be greater than that of its member legal entities. It may therefore be appropriate for internal models to be used for the group's ORSA even where the use of an internal model is not an approach appropriate to the nature, scale and complexity of its members.

Own risk and solvency assessment (ORSA) - continuity analysis

16.15 The supervisor requires:

- **the insurer, as part of its ORSA, to analyse its ability to continue in business, and the risk management and financial resources required to do so over a longer time horizon than typically used to determine regulatory capital requirements;**
- **the insurer's continuity analysis to address a combination of quantitative and qualitative elements in the medium and longer-term business strategy of the insurer and include projections of its future financial position and analysis of its ability to meet future regulatory capital requirements.**

16.15.1 An insurer should be able to demonstrate an ability to manage its risk over the longer term under a range of plausible adverse scenarios. An insurer's capital management plans and capital projections are therefore key to its overall risk management strategy. These should allow the insurer to determine how it could respond to unexpected changes in markets and economic conditions, innovations in the industry and other factors such as demographic, legal and regulatory, medical and social developments.

16.15.2 Where it is appropriate to the nature, scale and complexity to do so, supervisors should require an insurer to undertake periodic, forward-looking continuity analysis and modelling of its future financial position including its ability to continue to meet its regulatory capital requirements in future under various conditions. Insurers should ensure that the capital

and cash flow projections (before and after stress) and the management actions included in their forecasts, are approved at a sufficiently senior level.

16.15.3 In carrying out its continuity analysis, the insurer should also apply reverse stress testing to identify scenarios that would be the likely cause of business failure (e.g. where business would become unviable or the market would lose confidence in it) and the actions necessary to manage this risk. (See also Guidance 16.1.17).

16.15.4 As a result of continuity analysis, supervisors should encourage insurers to maintain contingency plans and procedures for use in a going and gone concern situation. Such plans should identify relevant countervailing measures and off-setting actions they could realistically take to restore/improve the insurer's capital adequacy or cash flow position after some future stress event and assess whether actions should be taken by the insurer in advance as precautionary measures.

16.15.5 A clear distinction should be made between the assessment of the current financial position and the projections, stress testing and scenario analyses used to assess an insurer's financial condition for the purposes of strategic risk management including maintaining solvency.[37] Continuity analysis helps to ensure sound, effective and complete risk management processes, strategies and systems. It helps to assess and maintain on an ongoing basis the amounts, types and distribution of financial resources needed to cover the nature and level of the risks to which an insurer is or might be exposed and to enable the insurer to identify and manage all reasonably foreseeable and relevant material risks. In doing so, the insurer assesses the impact of possible changes in business or risk strategy on the level of economic capital needed as well as the level of regulatory capital requirements.

16.15.6 Such continuity analysis should have a time horizon needed for effective business planning, for example 3 to 5 years, which is longer than typically used to determine regulatory capital requirements[38]. It should also place greater emphasis than may be considered in regulatory requirements on new business plans and product design and pricing, including embedded guarantees and options, and the assumptions appropriate given the way in which products are sold. The insurer's current premium levels and strategy for future premium levels are a key element in its continuity analysis. In order for continuity analysis to remain most meaningful, an insurer should also consider changes in external factors such as possible future events including changes in the political or economic situation.

16.15.7 Through the use of continuity analysis an insurer is better able to link its current financial position with future business plan projections and ensure its ability to maintain its financial position in the future. In this way the insurer further embeds its ERM into its ongoing and future operations.

16.15.8 An internal model may also be used for the continuity analysis allowing the insurer to assess the capital consequences of strategic business decisions in respect of its risk profile. For example, the insurer may decide

[37] The scenarios used for such assessments may be determined by the insurer or the supervisor.

[38] The comparison with the time horizon for determining regulatory capital requirements is with the defined time horizon over which the level of safety is specified or "shock period".

to reduce its exposure to certain risks by writing different types of business, in order to reduce the capital that is needed to be held against such risks, potentially freeing up resources for use elsewhere. This process of capital management enables the insurer to change its capital exposure as part of its long-term strategic decision making.

16.15.9 As a result of such strategic changes, the risk profile of an insurer may alter, so that different risks need to be assessed and quantified within its internal model. In this way, an internal model may sit within a cycle of strategic risk and capital management and provides the link between these two processes.

Additional guidance for insurance groups and insurance legal entities that are members of groups

16.15.10 An insurance group should also analyse its ability to continue in business and the risk management and financial resources it requires to do so. The insurance group's analysis should consider its ability to continue to exist as an insurance group, potential changes in group structure and the ability of its members to continue in business.

An insurance legal entity's continuity analysis should analyse the ongoing support from the group including the availability of financial support in adverse circumstances as well as the risks that may flow from the group to the insurance legal entity. Both the insurance legal entity and an insurance group of which it is a member should thus take into account the business risks they face including the potential impact of changes in the economic, political and regulatory environment.

16.15.11 In their continuity analysis, insurance groups should pay particular attention to intra-group cash flows, i.e. whether the insurance group will have available cash flows (e.g. from surpluses released from long-term funds, dividends from other subsidiaries, etc) and whether they will be transferable among group member entities to cover any payments of interest or capital on loans, to finance new business and to meet any other anticipated liabilities as they fall due. Insurance groups should outline what management actions they would take to manage the potential cash flow implications of a stress scenario (e.g. reducing new business, cutting dividends, etc).

16.15.12 The insurance group's continuity analysis should also consider the distribution of capital in the insurance group after stress and the possibility that subsidiaries within the insurance group may require recapitalisation (either due to breaches of local regulatory requirements, a shortfall in economic capital, or for other business reasons). The assessment should consider whether sufficient sources of surplus and transferable capital would exist elsewhere in the insurance group and identify what management actions might need to be taken (e.g. intra-group movements of resources, other intra-group transactions or group restructuring).

16.15.13 The insurance group should also apply reverse stress testing to identify scenarios that are likely to cause business failure within the insurance group and the actions necessary to manage this risk. (See Guidance 16.1.17.)

Role of supervision in risk management

16.16 The supervisor undertakes reviews of an insurer's risk management processes and its financial condition, including the ORSA. Where necessary, the supervisor requires strengthening of the insurer's risk management, solvency assessment and capital management processes.

16.16.1 The output of an insurer's ORSA should serve as an important tool in the supervisory review process by helping the supervisor to understand the risk exposure and solvency position of the insurer.

16.16.2 The insurer's ERM framework and risk management processes (including internal controls) are critical to solvency assessment. Supervisors should therefore assess the adequacy and soundness of the insurer's framework and processes by receiving the appropriate information, including the ORSA regularly. However, company operations are primarily the responsibility of the Board and Senior Management, and they need to be able to exercise their own discretion or business judgment to carry out these responsibilities.

16.16.3 Supervisors should review an insurer's internal controls and monitor its capital adequacy, requiring strengthening where necessary. Where internal models are used to calculate the regulatory capital requirements, particularly close interaction between the supervisor and insurer is important. In these circumstances, the supervisor may consider the insurer's internal model, its inputs and outputs and the validation processes, as a source of insight into the risk exposure and solvency position of the insurer. (See also ICP 8 Risk Management and Internal Controls.)

16.16.4 Supervisors should suitably monitor the techniques employed by the insurer for risk management and capital adequacy assessment and intervene where weaknesses are identified. Supervisors should not take a "one-size-fits-all" approach to insurers' risk management but base their expectations on the nature, scale and complexity of its business and risks. In order to do this, supervisors need to have sufficient and appropriate resources and capabilities. Supervisors may, for instance, have a risk assessment model or programme with which they can assess their insurers' overall condition (e.g. risk management, capital adequacy and solvency position) and ascertain the likelihood of insurers breaching their regulatory requirements. Supervisors may also prescribe minimum aspects that an ERM framework should address.

16.16.5 Supervisors should require appropriate information on risk management and risk and solvency assessments from each insurer they regulate. This not only provides supervisors with a long-term assessment of capital adequacy to aid in their assessment of insurers, but encourages insurers to use risk management effectively. This could also be achieved by, for instance, a supervisor requiring or encouraging insurers to provide a solvency and financial condition report. Such a report could include a description of the relevant material categories of risk that the insurer faces, its overall financial resource needs including its economic capital and regulatory capital requirements, as well as the capital available to meet these requirements, and projections of how such factors will develop in future. Where, after appropriate request from the supervisor,

an insurer fails to report adequate information about its risk and capital management practices, processes and procedures from which the supervisor can monitor the insurer, the supervisor should intervene or apply penalties appropriately. In addition, an insurer should have a duty to report a breach in regulatory requirements to the supervisor as soon as it occurs.

16.16.6 Supervisors should require the results of the most material risk modelling, stress testing and scenario analysis and the key assumptions underlying them to be reported to them, as appropriate to the nature, scale and complexity of the risks, and have access to all other results if requested. Where a supervisor considers that the calculations conducted by an insurer should be supplemented with additional calculations, it should be able to require the insurer to carry out those additional calculations. Where the supervisor considers that the insurer's response to the results of its risk modelling, stress testing and scenario testing are insufficient it should be able to direct the insurer to develop a more appropriate response. Supervisors should also consider available reverse stress tests performed by insurers where they wish to satisfy themselves that appropriate action is being taken to manage the risk of business failure. (See also Guidance 16.1.17.)

16.16.7 While insurers should carry out stress testing and scenario analysis and risk modelling that are most appropriate for their businesses, supervisors may also develop prescribed or standard tests and require insurers to perform them when circumstances are appropriate. One purpose of such testing may be to improve consistency of testing among a group of similar insurers. Another purpose may be to assess the financial stability of the insurance sector to economic or market stresses or other stresses that apply to a number of insurers simultaneously, such as pandemics, or major catastrophes. Such tests may be directed at selected insurers or all insurers. The criteria for scenarios used for standard tests should be developed as appropriate to the risk environment of insurers in each jurisdiction.

16.16.8 Forward-looking stress testing, scenario analysis and risk modelling of future capital positions and cash flows whether provided by the insurer's own continuity analysis or in response to supervisory requirements is a valuable tool for supervisors in assessing the financial condition of insurers, Such testing informs the discussion between supervisors and insurers on appropriate planning, comparing risk assessments against stress test outcomes, risk management and management actions and enables supervisors to consider the dynamic position of insurers and form a high-level assessment of whether the insurer is adequately capitalised to withstand a range of standardised and bespoke stresses.

16.16.9 Supervisors may use insurers' continuity analyses to increase the attention insurers pay to the robustness of their future financial position, the information on which they base decisions and their contingency planning. Such information enables supervisors to assess whether insurers should improve their ERM by taking additional countervailing measures and off-setting actions, either immediately, as a precautionary measure, or including them in future plans so as to reduce any projected

financial inadequacies, improve cash flows and increase their ability to restore their capital adequacy after stress events.

16.16.10 While an insurer may itself decide to hold additional capital or reduce its risks as a direct result of its continuity analysis as well as taking other management actions, the analysis should not of itself be used as a basis for increasing current regulatory capital requirements/solvency control levels.

16.16.11 Publicly disclosing information on risk management should work towards the IAIS's objective of improving the transparency and comparability of existing solvency requirements. The IAIS supports the need for balance regarding the level of information to disclose about an insurer's risk management whilst producing sufficient information for external and internal stakeholders which is useful and meaningful. Therefore, the IAIS recognises that the requirements for public disclosure of information on risk management, including possible disclosure of elements of a solvency and financial condition report, should be carefully considered by supervisors taking into account the proprietary nature of the information, whether it is commercially sensitive and the potential for its publication to have adverse effects on insurers.

16.16.12 Where an insurer's risk management practices and processes are not considered adequate by the supervisor, the supervisor should use its supervisory powers to take appropriate action. This could be in the form of further supervisory reporting or additional qualitative and quantitative requirements arising from the supervisor's assessment. However, additional quantitative requirements should only be applied in appropriate circumstances and subject to a transparent framework. If routinely applied, such measures may undermine a consistent application of standardised approaches to regulatory capital requirements.

16.16.13 Conversely, an insurer that manages its risks and capital well should be recognised and the level of supervision adapted to be commensurate with a risk-based supervisory approach. This does not necessarily mean a low level of supervision, but a level of supervision appropriate to the level of risk to which the insurer is exposed and its ability to manage the risks. An insurer's effective management of risk and capital does not necessarily mean the use of complex internal models, but a degree of risk management appropriate to the nature, scale and complexity of the insurer's risks. Importantly, risk sensitive regulatory financial requirements should provide the incentive for optimal alignment of the insurer's risk and capital management and regulatory requirements.

Additional guidance for insurance groups and insurance legal entities that are members of groups

16.16.14 The group-wide supervisor should undertake reviews of the risk management processes and financial condition of the insurance group. Where necessary, the group-wide supervisor should use its powers to require strengthening of the insurance group's risk management, solvency assessment and capital management processes, as appropriate to the nature, scale and complexity of risks at group level. .

The group-wide supervisor should inform the insurance legal entity supervisors of any action required.

16.16.15 The supervisory review of an insurance legal entity's risk management processes and its financial condition should include group risks. In particular, the supervisors involved should understand and assess the sources of risk, including emerging new risks to the insurance group and to insurance legal entities from any non-regulated entities within the group. Risk mitigation measures should be considered as possible response in treatment of non-regulated entities where a proper assessment is not possible or non-regulated entities threaten policyholder protection significantly. For example, the relevant supervisor could, where legally possible, forbid distribution of dividends to holding companies, issuance of new guarantees, or new participations in non-regulated entities. Such measures may also involve ring-fencing, such as portfolio transfers to another legal insurance entity in the group.

16.16.16 Questions the group-wide supervisor should consider when assessing the soundness, appropriateness and strengths and weaknesses of the insurance group ERM framework include, but are not be confined to:

- How well is the group's ERM framework tailored to the group?
- Are decisions influenced appropriately by the group's ERM framework outputs?
- How responsive is the group's ERM framework to changes in individual businesses and to the group structure?
- How does the framework bring into account intra-group transactions, risk mitigation and constraints on fungibility of capital/ transferability of assets/liquidity?
- What is the allocation of responsibilities for ERM in the group and what oversight is given of any outsourcing?
- What are the internal control systems and audit trails?
- What modelling and stress testing (including reverse stress testing) is done and how is modelling risk managed?

16.16.17 The group-wide supervisory review and assessment of the insurance group's ERM framework should consider the framework's soundness and appropriateness and identify its strengths, weaknesses and suitability as a basis for group-wide solvency assessment. The arrangements for managing conflicts of interest across an insurance group should be a particular focus in the supervisory review and assessment of an insurance group's ERM framework.

16.16.18 The soundness of the insurance group ERM framework may be a factor in the supervisory assessment of the risks to which the insurance group and its member insurance legal entities members are subject. This may in turn affect the level of capital that the insurance group is required to hold for regulatory purposes and any regulatory restrictions that are applied e.g. in terms of the recognition of diversification across the insurance group, the allowances made for operational risk and the allocation of capital within the insurance group.

16.16.19 Although it is not a requirement in general for an insurance legal entity or an insurance group to use internal models to carry out its ORSA, it may be considered appropriate by the supervisor in particular cases that the ORSA should use internal models in order to achieve a sound ERM framework. The effectiveness of an insurance group's ORSA may be affected by the degree of integration of its internal capital models, the extent to which it takes into account constraints on fungibility of capital and its ability to model changes in its structure, the transfer of risks around the insurance group and insurance group risk mitigation. These factors should be taken into account by the group-wide supervisor in its review of the insurance group's ORSA.

16.16.20 In considering the insurance group's financial position, the group-wide supervisor should review the insurance group's ORSA, including its continuity analysis. In addition, supervisors may wish to specify criteria or analyses that should form part of the supervisory risk assessments so as to achieve effective supervision and consistency across insurance groups. This may, for example, include prescribed stress tests that apply to insurance groups that are regarded as particularly important in terms of meeting supervisory objectives.

ICP 17 Capital Adequacy

The supervisor establishes capital adequacy requirements for solvency purposes so that insurers can absorb significant unforeseen losses and to provide for degrees of supervisory intervention.

Introductory Guidance

17.0.1 This ICP does not directly apply to non-insurance entities (regulated or unregulated) within an insurance group, but it does apply to insurance legal entities and insurance groups with regard to the risks posed to them by non-insurance entities.

Capital adequacy in the context of a total balance sheet approach

17.1 The supervisor requires that a total balance sheet approach is used in the assessment of solvency to recognise the interdependence between assets, liabilities, regulatory capital requirements and capital resources and to require that risks are appropriately recognised.

17.1.1 The overall financial position of an insurer should be based on consistent measurement of assets and liabilities and explicit identification and consistent measurement of risks and their potential impact on all components of the balance sheet. In this context, the IAIS uses the term total balance sheet approach to refer to the recognition of the interdependence between assets, liabilities, regulatory capital requirements and capital resources. A total balance sheet approach should also require that the impacts of relevant material risks on an insurer's overall financial position are appropriately and adequately recognised. [39]

17.1.2 The assessment of the financial position of an insurer for supervision purposes addresses the insurer's technical provisions, required capital and available capital resources. These aspects of solvency assessment (namely technical provisions and capital) are intrinsically inter-related and cannot be considered in isolation by a supervisor.

17.1.3 Technical provisions and capital have distinct roles, requiring a clear and consistent definition of both elements. Technical provisions represent the amount that an insurer requires to fulfil its insurance obligations and settle all commitments to policyholders and other beneficiaries arising over the lifetime of the portfolio. [40] In this ICP, the term regulatory capital requirements refers to financial requirements that are set by the supervisor and relates to the determination of amounts of capital that an insurer must have in addition to its technical provisions.

17.1.4 Technical provisions and regulatory capital requirements should be covered by adequate and appropriate assets, having regard to the nature

[39] It is noted that the total balance sheet approach is an overall concept rather than implying use of a particular methodology.

[40] This includes costs of settling all commitments to policyholders and other beneficiaries arising over the lifetime of the portfolio of policies, the expenses of administering the policies, the costs of hedging, reinsurance, and of the capital required to cover the remaining risks.

and quality of those assets. To allow for the quality of assets, supervisors may consider applying restrictions or adjustments (such as quantitative limits, asset eligibility criteria or "prudential filters") where the risks inherent in certain asset classes are not adequately covered by the regulatory capital requirements.

17.1.5 Capital resources may be regarded very broadly as the amount of the assets in excess of the amount of the liabilities. Liabilities in this context includes technical provisions and other liabilities (to the extent these other liabilities are not treated as capital resources - for example, liabilities such as subordinated debt may under certain circumstances be given credit for regulatory purposes as capital – see Guidance 17.10.8 - 17.10.11). Assets and liabilities in this context may include contingent assets and contingent liabilities.

17.1.6 In considering the quality of capital resources the supervisor should have regard to their characteristics, including the extent to which the capital is available to absorb losses (including considerations of subordination and priority), the extent of the permanent and/or perpetual nature of the capital and the existence of any mandatory servicing costs in relation to the capital.[41]

Additional guidance for insurance groups and insurance legal entities that are members of groups

17.1.7 The capital adequacy assessment of an insurance legal entity which is a member of an insurance group needs to consider the value of any holdings the insurance legal entity has in affiliates. Consideration may be given, either at the level of the insurance legal entity or the insurance group, to the risks attached to this value.

17.1.8 Where the value of holdings in affiliates is included in the capital adequacy assessment and the insurance legal entity is the parent of the group, group-wide capital adequacy assessment and legal entity assessment of the parent may be similar in outcome although the detail of the approach may be different. For example, a group-wide assessment may consolidate the business of the parent and its subsidiaries and assess the capital adequacy for the combined business while a legal entity assessment of the parent may consider its own business and its investments in its subsidiaries.

17.1.9 There are various possible approaches for group-wide supervision. More specifically, undertaking a capital adequacy assessment of an insurance group falls into two broad sets of approaches:

- group level focus and
- legal entity focus.

"Hybrid" or intermediate approaches which combine elements of approaches with a group and a legal entity focus may also be used.

17.1.10 The choice of approach would depend on the preconditions in a jurisdiction, the legal environment which may specify the level at which the group-wide capital requirements are set, the structure of the group

[41] More detailed guidance on the determination of capital resources is given below.

and the structure of the supervisory arrangements between the supervisors.

17.1.11 To further describe and compare the various approaches to group-wide capital adequacy assessment, a two dimensional continuum may be considered; on one axis – the organisational perspective – consideration is given to the extent to which a group is considered as a set of interdependent entities or a single integrated entity; on the other axis – the supervisory perspective – consideration is given to the relative weight of the roles of insurance legal entity supervision and group-wide supervision, without implying that the latter can replace the former in any way. It is recognised that supervisors around the world have adopted approaches corresponding to many points of this continuum. The continuum may be split into four quadrants as shown in Figure 17.1 below.

Figure 17.1

SUPERVISORY PERSPECTIVE	Legal Entity Focus	Group Level Focus
Large relative weight of group supervision with respect to local supervision	Insurance legal entity capital adequacy assessed for all (relevant) legal entities taking into account group impact. The results are binding and valid for local supervisors as well as for the group supervisor	Insurance legal entity capital adequacy assessed under the assumption that the group behaves as a single integrated entity. Local and group supervisors additionally define how much capital each legal entity has to hold.
Small relative weight of group supervision with respect to local supervision	Insurance legal entity capital adequacy assessed for all (relevant) legal entities taking into account group impact. These results are not binding; local supervisors apply insurance legal entity capital adequacy requirements.	Insurance legal entity capital adequacy assessed under the assumption that the group behaves as a single integrated entity. These results are not binding; local supervisors apply insurance legal entity capital adequacy requirements.

ORGANISATIONAL PERSPECTIVE

Additional guidance for insurance groups and insurance legal entities that are members of groups - group level focus

17.1.12 Under a group-wide capital adequacy assessment which takes a group level focus, the insurance group is considered primarily as a single integrated entity for which a separate assessment is made for the group

as a whole on a consistent basis, including adjustments to reflect constraints on the fungibility of capital and transferability of assets among group members. Hence under this approach, a total balance sheet approach to solvency assessment is followed which is (implicitly or explicitly) based on the balance sheet of the insurance group as a whole. However, adjustments may be necessary appropriately to take into account risks from non-insurance members of the insurance group, including cross-sector regulated entities and non-regulated entities.

17.1.13 Methods used for approaches with a group level focus may vary in the way in which group capital requirements are calculated. Either the group's consolidated accounts may be used as a basis or an aggregation method may be used. The former is already adjusted for intra-group holdings and further adjustments may then need to be made to reflect the fact that the group may not behave or be allowed to behave as one single entity[42]. This is particularly the case in stressed conditions. The latter method may sum surpluses or deficits (i.e. the difference between capital resources and capital requirements) for each insurance legal entity in the group with relevant adjustments for intra-group holdings in order to measure an overall surplus or deficit at group level. Alternatively, it may sum the insurance legal entity capital requirements and insurance legal entity capital resources separately in order to measure a group capital requirement and group capital resources. Where an aggregation approach is used for a cross-border insurance group, consideration should be given to consistency of valuation and capital adequacy requirements and of their treatment of intra-group transactions.

Additional guidance for insurance groups and insurance legal entities that are members of groups - legal entity focus

17.1.14 Under a group-wide capital adequacy assessment which takes a legal entity focus, the insurance group is considered primarily as a set of interdependent legal entities. The focus is on the capital adequacy of each of the parent and the other insurance legal entities in the insurance group, taking into account risks arising from relationships within the group, including those involving non-insurance members of the group. The regulatory capital requirements and resources of the insurance legal entities in the group form a set of connected results but no overall regulatory group capital requirement is used for regulatory purposes. This is still consistent with a total balance sheet approach, but considers the balance sheets of the individual group entities simultaneously rather than amalgamating them to a single balance sheet for the group as a whole. Methods used for approaches with a legal entity focus may vary in the extent to which there is a common basis for the solvency assessment for all group members and the associated communication and co-ordination needed among supervisors.

17.1.15 For insurance legal entities that are members of groups and for insurance sub-groups that are part of a wider insurance or other sector group, the additional reasonably foreseeable and relevant material risks arising from

[42] Consolidated accounts may be those used for accounting purposes or may differ (e.g. in terms of the entities included in the consolidation).

being a part of the group should be taken into account in capital adequacy assessment.

Establishing regulatory capital requirements

17.2 The supervisor establishes regulatory capital requirements at a sufficient level so that, in adversity, an insurer's obligations to policyholders will continue to be met as they fall due and requires that insurers maintain capital resources to meet the regulatory capital requirements.

Purpose and role of regulatory capital requirements and resources

17.2.1 An insurer's Board and Senior Management have the responsibility to ensure that the insurer has adequate and appropriate capital to support the risks it undertakes. Capital serves to reduce the likelihood of failure due to significantly adverse losses incurred by the insurer over a defined period, including decreases in the value of the assets and/or increases in the obligations of the insurer, and to reduce the magnitude of losses to policyholders in the event that the insurer fails.

17.2.2 From a regulatory perspective, the purpose of capital is to ensure that, in adversity, an insurer's obligations to policyholders will continue to be met as they fall due. Regulators should establish regulatory capital requirements at the level necessary to support this objective.

17.2.3 In the context of its own risk and solvency assessment **(ORSA),** the insurer would generally be expected to consider its financial position from a going concern perspective (that is, assuming that it will carry on its business as a going concern and continue to take on new business) but may also need to consider a run-off and/or winding-up perspective (e.g. where the insurer is in financial difficulty). The determination of regulatory capital requirements may also have aspects of both a going concern and a run-off[43] or winding-up perspective. In establishing regulatory capital requirements, therefore, supervisors should consider the financial position of insurers under different scenarios of operation.

17.2.4 From a macro-economic perspective, requiring insurers to maintain adequate and appropriate capital enhances the safety and soundness of the insurance sector and the financial system as a whole, while not increasing the cost of insurance to a level that is beyond its economic value to policyholders or unduly inhibiting an insurer's ability to compete in the marketplace. There is a balance to be struck between the level of risk that policyholder obligations will not be paid with the cost to policyholders of increased premiums to cover the costs of servicing additional capital.

17.2.5 The level of capital resources that insurers need to maintain for regulatory purposes is determined by the regulatory capital requirements specified by the supervisor. A deficit of capital resources relative to capital requirements determines the additional amount of capital that is required for regulatory purposes.

[43] In this context, "run-off" refers to insurers that are still solvent but have closed to new business and are expected to remain closed to new business.

17.2.6 Capital resources protect the interests of policyholders by meeting the following two objectives. They:

- reduce the probability of insolvency by absorbing losses on a going-concern basis or in run-off; and/or
- reduce the loss to policyholders in the event of insolvency or winding-up.

17.2.7 The extent to which elements of capital achieve the above outcomes will vary depending on their characteristics or "quality". For example, ordinary share capital may be viewed as achieving both of the above, whereas subordinated debt may be viewed largely as only protecting policyholders in insolvency. Capital which achieves both of the above is sometimes termed "going-concern capital" and capital which only reduces the loss to policyholders in insolvency is sometimes termed "wind-up capital" or "gone concern" capital. It would be expected that the former (i.e. going-concern capital instruments) should form the substantial part of capital resources.

17.2.8 For an insurer, the management and allocation of capital resources is a fundamental part of its business planning and strategies. In this context, capital resources typically serve a broader range of objectives than those in Guidance 17.2.6. For example, an insurer may use capital resources over and above the regulatory capital requirements to support future growth or to achieve a targeted credit rating.

17.2.9 It is noted that an insurer's capital management (in relation to regulatory requirements and own capital needs) should be supported and underpinned by establishing and maintaining a sound enterprise risk management framework, including appropriate risk and capital management policies, practices and procedures which are applied consistently across its organisation and are embedded in its processes. Maintaining sufficient capital resources alone is not sufficient protection for policyholders in the absence of disciplined and effective risk management policies and procedures. (See ICP 16 Enterprise Risk Management for Solvency Purposes.)

Additional guidance for insurance groups and insurance legal entities that are members of groups

17.2.10 The supervisor should require insurance groups to maintain capital resources to meet regulatory capital requirements. These requirements should take into account the non-insurance activities of the insurance group. For supervisors that undertake group-wide capital adequacy assessments with a group level focus this means maintaining insurance group capital resources to meet insurance group capital requirements for the group as a whole. For supervisors that undertake group-wide capital adequacy assessments with a legal entity focus this means maintaining capital resources in each insurance legal entity based on a set of connected regulatory capital requirements for the group's insurance legal entities which fully take the relationships and interactions between these legal entities and other entities in the insurance group into account.

17.2.11 It is not the purpose of group-wide capital adequacy assessment to replace assessment of the capital adequacy of the individual insurance legal entities in an insurance group. Its purpose is to require that group risks are appropriately allowed for and the capital adequacy of individual insurers is not overstated, e.g. as a result of multiple gearing and leverage of the quality of capital or as a result of risks emanating from the wider group, and that the overall impact of intra-group transactions is appropriately assessed.

17.2.12 Group-wide capital adequacy assessment considers whether the amount and quality of capital resources relative to required capital is adequate and appropriate in the context of the balance of risks and opportunities that group membership brings to the group as a whole and to insurance legal entities which are members of the group. The assessment should satisfy requirements relating to the structure of group-wide regulatory capital requirements and eligible capital resources and should supplement the individual capital adequacy assessments of insurance legal entities in the group. It should indicate whether there are sufficient capital resources available in the group so that, in adversity, obligations to policyholders will continue to be met as they fall due. If the assessment concludes that capital resources are inadequate or inappropriate then corrective action may be triggered either at a group (e.g. authorised holding or parent company level) or an insurance legal entity level.

17.2.13 The quantitative assessment of group-wide capital adequacy is one of a number of tools available to supervisors for group-wide supervision. If the overall financial position of a group weakens it may create stress for its members either directly through financial contagion and/or organisational effects or indirectly through reputational effects. Group-wide capital adequacy assessment should be used together with other supervisory tools, including in particular the capital adequacy assessment of insurance legal entities in the group. A distinction should be drawn between regulated entities (insurance and other sector) and non-regulated entities. It is necessary to understand the financial positions of both types of entities and their implications for the capital adequacy of the insurance group but this does not necessarily imply setting regulatory capital requirements for non-regulated entities. In addition, supervisors should have regard to the complexity of intra-group relationships (between both regulated and non-regulated entities), contingent assets and liabilities and the overall quality of risk management in assessing whether the overall level of safety required by the supervisor is being achieved.

17.2.14 For insurance legal entities that are members of groups and for insurance sub-groups that are part of a wider insurance or other sector group, capital requirements and capital resources should take into account all additional reasonably foreseeable and relevant material risks arising from being a part of any of the groups.

Structure of regulatory capital requirements - solvency control levels

17.3 The regulatory capital requirements include solvency control levels which trigger different degrees of intervention by the supervisor with an appropriate degree of urgency and requires coherence between the solvency control levels

established and the associated corrective action that may be at the disposal of the insurer and/or the supervisor.

Establishing solvency control levels

17.3.1 ***The supervisor should establish control levels that trigger intervention by the supervisor in an insurer's affairs when capital resources fall below these control levels. The control level may be supported by a specific fra***mework or by a more general framework providing the supervisor latitude of action. A supervisor's goal in establishing control levels is to safeguard policyholders from loss due to an insurer's inability to meet its obligations when due.

17.3.2 The solvency control levels provide triggers for action by the insurer and supervisor. Hence they should be set at a level that allows intervention at a sufficiently early stage in an insurer's difficulties so that there would be a realistic prospect for the situation to be rectified in a timely manner with an appropriate degree of urgency. At the same time, the reasonableness of the control levels should be examined in relation to the nature of the corrective measures. The risk tolerance of the supervisor will influence both the level at which the solvency control levels are set and the intervention actions that are triggered.

17.3.3 When establishing solvency control levels it is recognised that views about the level that is acceptable may differ from jurisdiction to jurisdiction and by types of business written and will reflect, amongst other things, the extent to which the pre-conditions for effective supervision exist within the jurisdiction and the risk tolerance of the particular supervisor. The IAIS recognises that jurisdictions will acknowledge that a certain level of insolvencies may be unavoidable and that establishing an acceptable threshold may facilitate a competitive marketplace for insurers and avoid inappropriate barriers to market entry.

17.3.4 The criteria used by the supervisor to establish solvency control levels should be transparent. This is particularly important where legal action may be taken in response to an insurer violating a control level. In this case, control levels should generally be simple and readily explainable to a court when seeking enforcement of supervisory action.

17.3.5 Supervisors may need to consider different solvency control levels for different modes of operation of the insurer - such as an insurer in run-off or an insurer operating as a going concern. These different scenarios and considerations are discussed in more detail in Guidance 17.6.3 - 17.6.5.

17.3.6 In addition, the supervisor should consider the allowance for management discretion and future action in response to changing circumstances or particular events. In allowing for management discretion, supervisors should only recognise actions which are practical and realistic in the circumstances being considered[44].

17.3.7 Other considerations in establishing solvency control levels include:

[44] The supervisor should carefully consider the appropriateness of allowing for such management discretion in the particular case of the MCR as defined in Standard 17.4.

- the way in which the quality of capital resources is addressed by the supervisor;
- the coverage of risks in the determination of technical provisions and regulatory capital requirements and the extent of the sensitivity or stress analysis underpinning those requirements;
- the relation between different levels (for example the extent to which a minimum is set at a conservative level);
- the powers of the supervisor to set and adjust solvency control levels within the regulatory framework;
- the accounting and actuarial framework that applies in the jurisdiction (in terms of the valuation basis and assumptions that may be used and their impact on the values of assets and liabilities that underpin the determination of regulatory capital requirements);
- the comprehensiveness and transparency of disclosure frameworks in the jurisdiction and the ability for markets to exercise sufficient scrutiny and impose market discipline;
- policyholder priority and status under the legal framework relative to other creditors in the jurisdiction;
- overall level of capitalisation in the insurance sector in the jurisdiction;
- overall quality of risk management and governance frameworks in the insurance sector in the jurisdiction;
- the development of capital markets in the jurisdiction and its impact on the ability of insurers to raise capital; and
- the balance to be struck between protecting policyholders and the impact on the effective operation of the insurance sector and considerations around unduly onerous levels and costs of regulatory capital requirements.

Additional guidance for insurance groups and insurance legal entities that are members of groups

17.3.8 While the general considerations in Guidance 17.3.1 to 17.3.7 above on the establishment of solvency control levels apply in a group-wide context as well as a legal entity context, the supervisory actions triggered at group level will be likely to differ from those at legal entity level. As a group is not a legal entity the scope for direct supervisory action in relation to the group as a whole is more limited and action may need to be taken through co-ordinated action at insurance legal entity level.

17.3.9 Nevertheless, group solvency control levels are a useful tool for identifying a weakening of the financial position of a group as a whole or of particular parts of a group, which may, for example, increase contagion risk or impact reputation which may not otherwise be readily identified or assessed by supervisors of individual group entities. The resulting timely identification and mitigation of a weakening of the financial position of a

group may thus address a threat to the stability of the group or its component insurance legal entities.

17.3.10 Group-wide solvency control levels may trigger a process of coordination and cooperation between different supervisors of group entities which will facilitate mitigation and resolution of the impact of group-wide stresses on insurance legal entities within a group. Group-wide control levels may also provide a trigger for supervisory dialogue with the group's management.

Structure of regulatory capital requirements - triggers for supervisory intervention in the context of legal entity capital adequacy assessment

17.4 In the context of insurance legal entity capital adequacy assessment, the regulatory capital requirements establish:

- **a solvency control level above which the supervisor does not intervene on capital adequacy grounds. This is referred to as the Prescribed Capital Requirement (PCR). The PCR is defined such that assets will exceed technical provisions and other liabilities with a specified level of safety over a defined time horizon.**
- **a solvency control level at which, if breached, the supervisor would invoke its strongest actions, in the absence of appropriate corrective action by the insurance legal entity. This is referred to as the Minimum Capital Requirement (MCR). The MCR is subject to a minimum bound below which no insurer is regarded to be viable to operate effectively.**

17.4.1 A range of different intervention actions should be taken by a supervisor depending on the event or concern that triggers the intervention. Some of these triggers will be linked to the level of an insurer's capital resources relative to the level at which regulatory capital requirements are set.

17.4.2 In broad terms, the highest regulatory capital requirement, the Prescribed Capital Requirement (PCR), will be set at the level at which the supervisor would not require action to increase the capital resources held or reduce the risks undertaken by the insurer[45]. However if the insurer's capital resources were to fall below the level at which the PCR is set, the supervisor would require some action by the insurer to either restore capital resources to at least the PCR level or reduce the level of risk undertaken (and hence the required capital level).

17.4.3 The regulatory objective to require that, in adversity, an insurer's obligations to policyholders will continue to be met as they fall due will be achieved without intervention if technical provisions and other liabilities[46] are expected to remain covered by assets over a defined period, to a specified level of safety. As such, the PCR should be determined at a

[45] Note that this does not preclude the supervisor from intervention or requiring action by the insurer for other reasons, such as weaknesses in the risk management or governance of the insurer. Nor does it preclude the supervisor from intervention when the insurer's capital resources are currently above the PCR but are expected to fall below that level in the short term. To illustrate, the supervisor may establish a trend test (a time series analysis). A sufficiently adverse trend would require some supervisory action. The trend test would support the objective of early regulatory intervention by considering the speed at which capital deterioration is developing.

[46] To the extent these liabilities are not treated as capital resources.

level such that the insurer is able to absorb the losses from adverse events that may occur over that defined period and the technical provisions remain covered at the end of the period.

17.4.4 The Minimum Capital Requirement (MCR) represents the supervisory intervention point at which the supervisor would invoke its strongest actions, if further capital is not made available[47]. Therefore, the main aim of the MCR is to provide the ultimate safety net for the protection of the interests of policyholders.

17.4.5 These actions could include stopping the activities of the insurer, withdrawal of the insurer's licence, requiring the insurer to close to new business and run-off the portfolio, transfer its portfolio to another insurer, arrange additional reinsurance, or other specified actions. This position is different from the accounting concept of insolvency as the MCR would be set at a level in excess of that at which the assets of the insurer were still expected to be sufficient to meet the insurer's obligations to existing policyholders as they fall due. The PCR cannot be less than the MCR, and therefore the MCR may also provide the basis of a lower bound for the PCR, which may be especially appropriate in cases where the PCR is determined on the basis of an insurer's internal model[48] approved for use in determining regulatory capital requirements by the supervisor.

17.4.6 In establishing a minimum bound on the MCR below which no insurer is regarded to be viable to operate effectively, the supervisor may, for example, apply a market-wide nominal floor[49] to the regulatory capital requirements, based on the need for an insurer to operate with a certain minimal critical mass and consideration of what may be required to meet minimum standards of governance and risk management. Such a nominal floor might vary between lines of business or type of insurer and is particularly relevant in the context of a new insurer or line of business.

17.4.7 Regulatory capital requirements may include additional solvency control levels between the level at which the supervisor takes no intervention action from a capital perspective and the strongest intervention point (that is, between the PCR and MCR levels). These control levels may be set at levels that correspond to a range of different intervention actions that may be taken by the supervisor itself or actions which the supervisor would require of the insurer according to the severity or level of concern regarding adequacy of the capital held by the insurer. These additional control levels may be formally established by the supervisor with explicit

[47] Note that this does not preclude such actions being taken by the supervisor for other reasons, and even if the MCR is met or exceeded.

[48] The term "internal model" refers to "a risk measurement system developed by an insurer to analyse its overall risk position, to quantify risks and to determine the economic capital required to meet those risks" . Internal models may also include partial models which capture a subset of the risks borne by the insurer using an internally developed measurement system which is used in determining the insurer's economic capital. The IAIS is aware that insurers use a variety of terms to describe their risk and capital assessment processes, such as "economic capital model", "risk-based capital model", or "business model". The IAIS considers that such terms could be used interchangeably to describe the processes adopted by insurers in the management of risk and capital within their business on an economic basis. For the purposes of consistency, the term "internal model" is used throughout.

[49] In this context, a market-wide nominal floor may, for example, be an absolute monetary minimum amount of capital required to be held by an insurer in a jurisdiction.

intervention actions linked to particular control levels. Alternatively, these additional control levels may be structured less formally, with a range of possible intervention actions available to the supervisor depending on the particular circumstances. In either case the possible triggers and range of intervention actions should be appropriately disclosed by the supervisor.

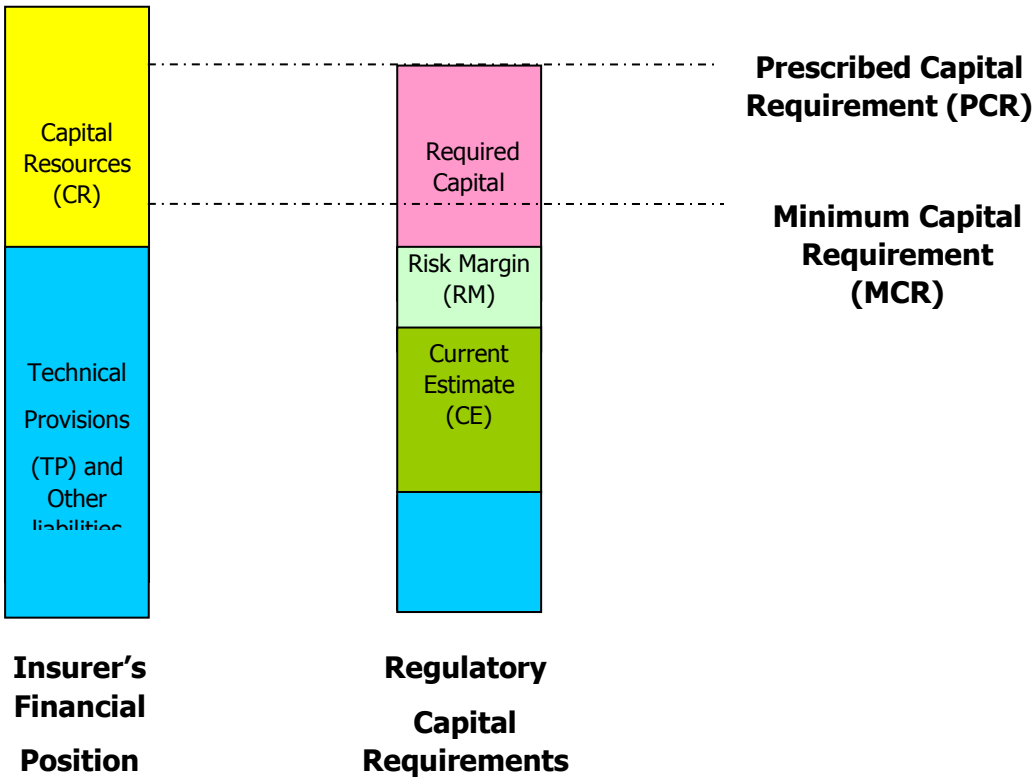
17.4.8 Possible intervention actions include:

- measures that are intended to enable the supervisor to better assess and/or control the situation, either formally or informally, such as increased supervision activity or reporting, or requiring auditors or actuaries to undertake an independent review or extend the scope of their examinations;
- measures to address capital levels such as requesting capital and business plans for restoration of capital resources to required levels, limitations on redemption or repurchase of equity or other instruments and/or dividend payments;
- measures intended to protect policyholders pending strengthening of the insurer's capital position, such as restrictions on licences, premium volumes, investments, types of business, acquisitions, reinsurance arrangements;
- measures that strengthen or replace the insurer's management and/or risk management framework and overall governance processes;
- measures that reduce or mitigate risks (and hence required capital) such as requesting reinsurance, hedging and other mechanisms; and/or
- refusing, or imposing conditions on, applications submitted for regulatory approval such as acquisitions or growth in business.

17.4.9 In establishing the respective control levels, consideration should be had for these possibilities and the scope for an insurer with capital at this level to be able to increase its capital resources or to be able to access appropriate risk mitigation tools from the market.

Figure 17.2 below illustrates the concept of solvency control levels in the context of establishing regulatory capital requirements:

Figure 17.2: Solvency control levels and regulatory capital requirements



Structure of regulatory capital requirements - Triggers for supervisory intervention in the context of group-wide capital adequacy assessment

17.5 In the context of group-wide capital adequacy assessment, the regulatory capital requirements establish solvency control levels that are appropriate in the context of the approach to group-wide capital adequacy that is applied.

17.5.1 The supervisor should establish solvency control levels that are appropriate in the context of the approach that is adopted for group-wide capital adequacy assessment. The supervisor should also define the relationship between these solvency control levels and those at legal entity level for insurers that are members of the group. The design of solvency control levels depends on a number of factors. These include the supervisory perspective, i.e. the relative weight placed on group-wide supervision and legal entity supervision, and the organisational perspective, i.e. the extent to which a group is considered as a set of interdependent entities or a single integrated entity. The solvency control levels are likely to vary according to the particular group and the supervisors involved. (See Figure 17.1.) The establishment of group-wide solvency control levels should be such as to enhance the overall supervision of the insurers in the group.

17.5.2 Having group-wide solvency control levels does not necessarily mean establishing a single regulatory capital requirement at group level. For

example, under a legal entity approach consideration of the set of capital requirements for individual entities (and interrelationships between them) may enable appropriate decisions to be taken about supervisory intervention on a group-wide basis. However, this requires the approach to be sufficiently well developed for group risks to be taken into account on a complete and consistent basis in the capital adequacy assessment of insurance legal entities in a group. To achieve consistency for insurance legal entity assessments, it may be necessary to adjust the capital requirements used for insurance legal entities so they are suitable for group-wide assessment.

17.5.3 One approach may be to establish a single group-wide PCR or a consistent set of PCRs for insurance legal entities that are members of the group which, if met, would mean that no supervisory intervention at group level for capital reasons would be deemed necessary or appropriate. Such an approach may assist, for example, in achieving consistency of approach towards similar organisations with a branch structure and different group structures e.g. following a change in structure of a group. Where a single group-wide PCR is determined, it may differ from the sum of insurance legal entity PCRs because of group factors including group diversification effects, group risk concentrations and intra-group transactions. Similarly, where group-wide capital adequacy assessment involves the determination of a set of PCRs for the insurance legal entities in an insurance group, these may differ from the insurance legal entity PCRs if group factors are reflected differently in the group capital assessment process. Differences in the level of safety established by different jurisdictions in which the group operates should be considered when establishing group-wide PCR(s).

17.5.4 The establishment of a single group-wide MCR might also be considered and may, for example, trigger supervisory intervention to restructure the control and/or capital of the group. A possible advantage of this approach is that it may encourage a group solution where an individual insurer is in financial difficulty and capital is sufficiently fungible and assets are transferable around the group. Alternatively, the protection provided by the supervisory power to intervene at individual entity level on breach of an insurance legal entity MCR may be regarded as sufficient.

17.5.5 The solvency control levels adopted in the context of group-wide capital adequacy assessment should be designed so that together with the solvency control levels at insurance legal entity level they represent a consistent ladder of supervisory intervention. For example, a group-wide PCR should trigger supervisory intervention before a group-wide MCR because the latter may invoke the supervisor's strongest actions. Also, if a single group-wide PCR is used it may be appropriate for it to have a floor equal to the sum of the legal entity MCRs of the individual entities in the insurance group. Otherwise, no supervisory intervention into the operation of the group would be required even though at least one of its member insurers had breached its MCR.

17.5.6 Supervisory intervention triggered by group-wide solvency control levels should take the form of coordinated action by relevant group supervisors. This may, for example, involve increasing capital at holding company level or strategically reducing the risk profile or increasing capital in

insurance legal entities within the group. Such supervisory action may be exercised via the insurance legal entities within a group and, where insurance holding companies are authorised, via those holding companies. Supervisory action in response to breaches of group-wide solvency control levels should not alter the existing division of statutory responsibilities of the supervisors responsible for authorising and supervising each individual insurance legal entity.

Structure of regulatory capital requirements - approaches to determining regulatory capital requirements

17.6 The regulatory capital requirements are established in an open and transparent process, and the objectives of the regulatory capital requirements and the bases on which they are determined are explicit. In determining regulatory capital requirements, the supervisor allows a set of standardised and, if appropriate, other approved more tailored approaches such as the use of (partial or full) internal models.

17.6.1 Transparency as to the regulatory capital requirements that apply is required to facilitate effective solvency assessment and supports its enhancement, comparability and convergence internationally.

17.6.2 The supervisor may develop separate approaches for the determination of different regulatory capital requirements, in particular for the determination of the MCR and the PCR. For example, the PCR and MCR may be determined by two separate methods, or the same methods and approaches may be used but with two different levels of safety specified. In the latter case, for example, the MCR may be defined as a simple proportion of the PCR, or the MCR may be determined on different specified target criteria to those specified for the PCR.

17.6.3 The PCR would generally be determined on a going concern basis, i.e. in the context of the insurer continuing its operations. On a going concern basis, an insurer would be expected to continue to take on new risks during the established time horizon. Therefore, in establishing the regulatory capital level to provide an acceptable level of solvency, the potential growth in an insurer's portfolio should be considered.

17.6.4 Capital should also be capable of protecting policyholders if the insurer were to close to new business. Generally, the determination of capital on a going concern basis would not be expected to be less than would be required if it is assumed that the insurer were to close to new business. However, this may not be true in all cases, since some assets may lose some or all of their value in the event of a winding-up or run-off, for example, because of a forced sale. Similarly, some liabilities may actually have an increased value if the business does not continue (e.g. claims handling expenses).

17.6.5 Usually the MCR would be constructed taking into consideration the possibility of closure to new business. It is, however, relevant to also consider the going concern scenario in the context of establishing the level of the MCR, as an insurer may continue to take on new risks up until the point at which MCR intervention is ultimately triggered. The supervisor should consider the appropriate relationship between the PCR and MCR, establishing a sufficient buffer between these two levels (including

consideration of the basis on which the MCR is generated) within an appropriate continuum of solvency control levels, having regard for the different situations of business operation and other relevant considerations.

17.6.6 It should be emphasised that meeting the regulatory capital requirements should not be taken to imply that further financial injections will not be necessary under any circumstances in future.

17.6.7 Regulatory capital requirements may be determined using a range of approaches, such as standard formulae, or other approaches, more tailored to the individual insurer (such as partial or full internal models), which are subject to approval by the relevant supervisors.[50] Regardless of the approach used, the principles and concepts that underpin the objectives for regulatory capital requirements described in this ICP apply and should be applied consistently by the supervisor to the various approaches. The approach adopted for determining regulatory capital requirements should take account of the nature and materiality of the risks insurers face generally and, to the extent practicable, should also reflect the nature, scale and complexity of the risks of the particular insurer.

17.6.8 Standardised approaches, in particular, should be designed to deliver capital requirements which reasonably reflect the overall risk to which insurers are exposed, while not being unduly complex. Standardised approaches may differ in level of complexity depending on the risks covered and the extent to which they are mitigated or may differ in application based on classes of business (e.g. life and non-life). Standardised approaches should be appropriate to the nature, scale and complexity of the risks that insurers face and should include approaches that are feasible in practice for insurers of all types including small and medium sized insurers and captives taking into account the technical capacity that insurers need to manage their businesses effectively.

17.6.9 By its very nature a standardised approach may not be able to fully and appropriately reflect the risk profile of each individual insurer. Therefore, where appropriate, a supervisor should allow the use of more tailored approaches subject to approval. In particular, where an insurer has an internal model (or partial internal model) that appropriately reflects its risks and is integrated into its risk management and reporting, the supervisor should allow the use of such a model to determine more tailored regulatory capital requirements, where appropriate[51]. The use of the internal model for this purpose would be subject to prior approval by the supervisor based on a transparent set of criteria and would need to be evaluated at regular intervals. In particular, the supervisor would need to be satisfied that the insurer's internal model is, and remains, appropriately calibrated relative to the target criteria established by the supervisor (see Guidance 17.12.1 to 17.12.18).

[50] A more tailored approach which is not an internal model might include, for example, approved variations in factors contained in a standard formula or prescribed scenario tests which are appropriate for a particular insurer or group of insurers.

[51] It is noted that the capacity for a supervisor to allow the use of internal models will need to take account of the sufficiency of resources available to the supervisor.

17.6.10 The supervisor should also be clear on whether an internal model may be used for the determination of the MCR. In this regard, the supervisor should take into account the main objective of the MCR (i.e. to provide the ultimate safety net for the protection of policyholders) and the ability of the MCR to be defined in a sufficiently objective and appropriate manner to be enforceable (refer to Guidance 17.3.4).

17.7 The supervisor addresses all relevant and material categories of risk in insurers and is explicit as to where risks are addressed, whether solely in technical provisions, solely in regulatory capital requirements or if addressed in both, as to the extent to which the risks are addressed in each. The supervisor is also explicit as to how risks and their aggregation are reflected in regulatory capital requirements.

Types of risks to be addressed

17.7.1 The supervisor should address all relevant and material categories of risk - including as a minimum underwriting risk, credit risk, market risk, operational risk and liquidity risk. This should include any significant risk concentrations, for example, to economic risk factors, market sectors or individual counterparties, taking into account both direct and indirect exposures and the potential for exposures in related areas to become more correlated under stressed circumstances.

Dependencies and interrelations between risks

17.7.2 The assessment of the overall risk that an insurer is exposed to should address the dependencies and interrelationships between risk categories (for example, between underwriting risk and market risk) as well as within a risk category (for example, between equity risk and interest rate risk). This should include an assessment of potential reinforcing effects between different risk types as well as potential "second order effects", i.e. indirect effects to an insurer's exposure caused by an adverse event or a change in economic or financial market conditions.[52] It should also consider that dependencies between different risks may vary as general market conditions change and may significantly increase during periods of stress or when extreme events occur. "Wrong way risk", which is defined as the risk that occurs when exposure to counterparties, such as financial guarantors, is adversely correlated to the credit quality of those counterparties, should also be considered as a potential source of significant loss e.g. in connection with derivative transactions. Where the determination of an overall capital requirement takes into account diversification effects between different risk types, the insurer should be able to explain the allowance for these effects and ensure that it considers how dependencies may increase under stressed circumstances.

Allowance for risk mitigation

17.7.3 Any allowance for reinsurance in determining regulatory capital requirements should consider the possibility of breakdown in the

[52] For example, a change in the market level of interest rates could trigger an increase of lapse rates on insurance policies.

effectiveness of the risk transfer and the security of the reinsurance counterparty and any measures used to reduce the reinsurance counterparty exposure. Similar considerations would also apply for other risk mitigants, for example derivatives.

Transparency of recognition of risks in regulatory requirements

17.7.4 The supervisor should be explicit as to where risks are addressed, whether solely in technical provisions, solely in regulatory capital requirements or if addressed in both, as to the extent to which the risks are addressed in each. The solvency requirements should also clearly articulate how risks are reflected in regulatory capital requirements, specifying and publishing the level of safety to be applied in determining regulatory capital requirements, including the established target criteria (refer to Standard 17.8).

Treatment of risks which are difficult to quantify

17.7.5 The IAIS recognises that some risks, such as strategic risk, reputational risk, liquidity risk and operational risk, are less readily quantifiable than the other main categories of risks. Operational risk, for example, is diverse in its composition and depends on the quality of systems and controls in place. The measurement of operational risk, in particular, may suffer from a lack of sufficiently uniform and robust data and well developed valuation methods. Jurisdictions may choose to base regulatory capital requirements for these less readily quantifiable risks on some simple proxies for risk exposure and/or stress and scenario testing. For particular risks (such as liquidity risk), holding additional capital may not be the most appropriate risk mitigant and it may be more appropriate for the supervisor to require the insurer to control these risks via exposure limits and/or qualitative requirements such as additional systems and controls.

17.7.6 However, the IAIS envisages that the ability to quantify some risks (such as operational risk) will improve over time as more data become available or improved valuation methods and modelling approaches are developed. Further, although it may be difficult to quantify risks, it is important that an insurer nevertheless addresses all material risks in its own risk and solvency assessment.

17.8 The supervisor sets appropriate target criteria for the calculation of regulatory capital requirements, which underlie the calibration of a standardised approach. Where the supervisor allows the use of approved more tailored approaches such as internal models for the purpose of determining regulatory capital requirements, the target criteria underlying the calibration of the standardised approach are also used by those approaches for that purpose to require broad consistency among all insurers within the jurisdiction.

17.8.1 The level at which regulatory capital requirements are set will reflect the risk tolerance of the supervisor. Reflecting the IAIS's principles-based approach, this ICP does not prescribe any specific methods for determining regulatory capital requirements. However, the IAIS's view is that it is important that individual jurisdictions set appropriate target criteria (such as risk measures, confidence levels or time horizons) for

their regulatory capital requirements. Further, each jurisdiction should outline clear principles for the key concepts for determining regulatory capital requirements, considering the factors that a supervisor should take into account in determining the relevant parameters as outlined in this ICP.

17.8.2 Where a supervisor allows the use of other more tailored approaches to determine regulatory capital requirements, the target criteria established should be applied consistently to those approaches. In particular, where a supervisor allows the use of internal models for the determination of regulatory capital requirements, the supervisor should apply the target criteria in approving the use of an internal model by an insurer for that purpose. This should achieve broad consistency among all insurers and a similar level of protection for all policyholders, within the jurisdiction.

17.8.3 With regards to the choice of the risk measure and confidence level to which regulatory capital requirements are calibrated, the IAIS notes that some supervisors have set a confidence level for regulatory purposes which is comparable with a minimum investment grade level. Some examples have included a 99.5% VaR calibrated confidence level over a one year timeframe[53], 99% TVaR over one year and 95% TVaR over the term of the policy obligations.

17.8.4 In regards to the choice of an appropriate time horizon, the determination and calibration of the regulatory capital requirements needs to be based on a more precise analysis, distinguishing between:

- the period over which a shock is applied to a risk – the “shock period”; and
- the period over which the shock that is applied to a risk will impact the insurer – the “effect horizon”.

17.8.5 For example, a one-off shift in the interest rate term structure during a shock period of one year has consequences for the discounting of the cash flows over the full term of the policy obligations (the effect horizon). A judicial opinion (e.g. on an appropriate level of compensation) in one year (the shock period) may have permanent consequences for the value of claims and hence will change the projected cash flows to be considered over the full term of the policy obligations (the effect horizon).

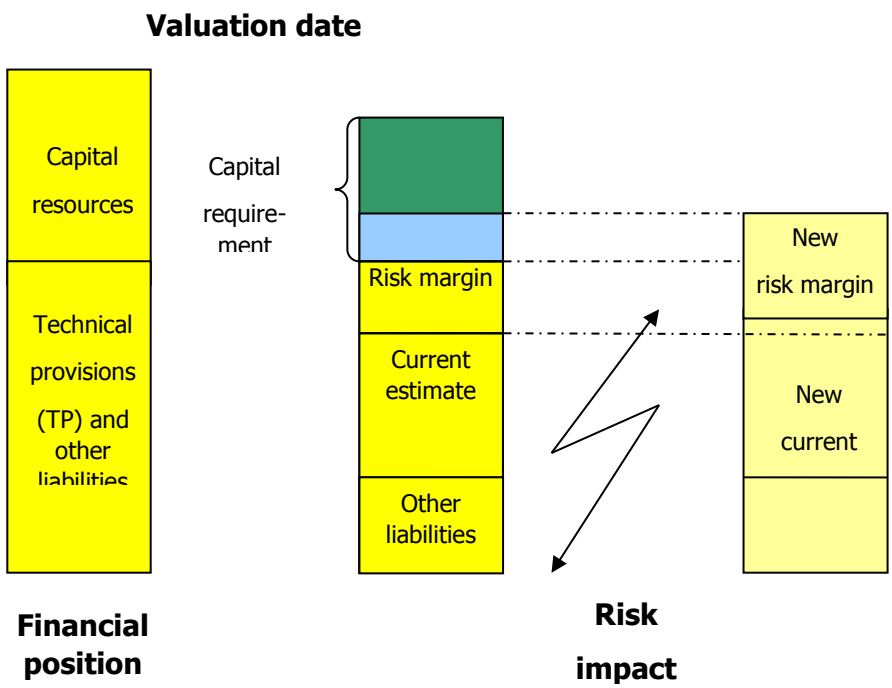
17.8.6 The impact on cash flows of each stress that is assumed to occur during the shock period will need to be calculated over the period for which the shock will affect the relevant cash flows (the effect horizon). In many cases this will be the full term of the insurance obligations. In some cases, realistic allowance for offsetting reductions in discretionary benefits to policyholders or other offsetting management actions may be considered, where they could and would be made and would be effective in reducing policy obligations or in reducing risks in the circumstances of the stress. In essence, at the end of the shock period, capital has to be sufficient so that assets cover the technical provisions (and other liabilities) re-determined at the end of the shock period. The re-determination of the

[53] This is the level expected in Australia for those insurers that seek approval to use an internal model to determine their MCR. It is also the level used for the calculation of the risk-based Solvency Capital Requirement under the European Solvency II regime.

technical provisions would allow for the impact of the shock on the technical provisions over the full time horizon of the policy obligations.

17.8.7 Figure 17.3 summarises key aspects relevant to the determination of regulatory capital requirements:

Figure **17.3**: Illustration of determination of regulatory capital requirements



17.8.8 For the determination of the technical provisions, an insurer is expected to consider the uncertainty attached to the policy obligations, that is, the likely (or expected) variation of future experience from what is assumed in determining the current estimate, over the full period of the policy obligations. As indicated above, regulatory capital requirements should be calibrated such that assets exceed the technical provisions (and other liabilities) over a defined shock period with an appropriately high degree of safety. That is, the regulatory capital requirements should be set such that the insurer's capital resources can withstand a range of predefined shocks or stress scenarios that are assumed to occur during that shock period (and which lead to significant unexpected losses over and above the expected losses that are captured in the technical provisions).

Calibration and measurement error

17.8.9 The risk of measurement error inherent in any approach used to determine capital requirements should be considered. This is especially important where there is a lack of sufficient statistical data or market information to assess the tail of the underlying risk distribution. To mitigate model error, quantitative risk calculations should be blended with qualitative assessments, and, where practicable, multiple risk measurement tools should be used. To help assess the economic

appropriateness of risk-based capital requirements, information should be sought on the nature, degree and sources of the uncertainty surrounding the determination of capital requirements in relation to the established target criteria.

17.8.10 The degree of measurement error inherent, in particular, in a standardised approach depends on the degree of sophistication and granularity of the methodology used. A more sophisticated standardised approach has the potential to be aligned more closely to the true distribution of risks across insurers. However, increasing the sophistication of the standardised approach is likely to imply higher compliance costs for insurers and more intensive use of supervisory resources (for example, in validating the calculations). The calibration of the standardised approach therefore needs to balance the trade-off between risk-sensitivity and implementation costs.

Procyclicality

17.8.11 When applying risk-based regulatory capital requirements, there is a risk that an economic downturn will trigger supervisory interventions that exacerbate the economic crises, thus leading to an adverse "procyclical" effect. For example, a severe downturn in share markets may result in a depletion of the capital resources of a major proportion of insurers. This in turn may force insurers to sell shares and to invest in less risky assets in order to decrease their regulatory capital requirements. A simultaneous massive selling of shares by insurers could, however, put further pressure on the share markets, thus leading to a further drop in share prices and to a worsening of the economic crises.

17.8.12 However, the system of solvency control levels required enables supervisors to introduce a more principles-based choice of supervisory interventions in cases where there may be a violation of the PCR control level and this can assist in avoiding exacerbation of procyclicality effects: supervisory intervention is able to be targeted and more flexible in the context of an overall economic downturn so as to avoid measures that may have adverse macroeconomic effects.

17.8.13 It could be contemplated whether further explicit procyclicality-dampening measures would be needed. This may include allowing a longer period for corrective measures or allowance for the calibration of the regulatory capital requirements to reflect procyclicality dampening measures. Overall, when such dampening measures are applied, an appropriate balance needs to be achieved to preserve the risk sensitivity of the regulatory capital requirements.

17.8.14 In considering the impacts of procyclicality, the influence of external factors (for example, the influence of credit rating agencies) should be given due regard. The impacts of procyclicality also heighten the need for supervisory cooperation and communication.

Additional guidance for insurance groups and insurance legal entities that are members of groups

17.8.15 Approaches to determining group-wide regulatory capital requirements will depend on the overall approach taken to group-wide capital adequacy assessment. Where a group level approach is used, either the group's consolidated accounts may be taken as a basis for calculating group-wide capital requirements or the requirements of each insurance legal entity may be aggregated or a mixture of these methods may be used. For example, if a different treatment is required for a particular entity (for example, an entity located in a different jurisdiction) it might be disaggregated from the consolidated accounts and then included in an appropriate way using a deduction and aggregation approach.

17.8.16 Where consolidated accounts are used, the requirements of the jurisdiction in which the ultimate parent of the group is located would normally be applied, consideration should also be given to the scope of the consolidated accounts used for accounting purposes as compared to the consolidated balance sheet used as a basis for group-wide capital adequacy assessment to require, for example, identification and appropriate treatment of non-insurance group entities.

17.8.17 Where the aggregation method is used (as described in Guidance 17.1.13), or where a legal entity focus is adopted (as described in Guidance 17.1.14), consideration should be given as to whether local capital requirements can be used for insurance legal entities within the group which are located in other jurisdictions or whether capital requirements should be recalculated according to the requirements of the jurisdiction in which the ultimate parent of the group is located.

Group-specific risks

17.8.18 There are a number of group-specific factors which should be taken into account in determining group-wide capital requirements including diversification of risk across group entities, intra-group transactions, risks arising from non-insurance group entities, treatment of group entities located in other jurisdictions and treatment of partially-owned entities and minority interests. Particular concerns may arise from a continuous sequence of internal financing within the group, or closed loops in the financing scheme of the group.

17.8.19 Group specific risks posed by each group entity to insurance members of the group and to the group as a whole are a key factor in an overall assessment of group-wide capital adequacy. Such risks are typically difficult to measure and mitigate and include notably contagion risk (financial, reputational, legal), concentration risk, complexity risk and operational/organisational risks. As groups can differ significantly it may not be possible to address these risks adequately using a standardised approach for capital requirements. It may therefore be necessary to address group specific risks through the use of more tailored approaches to capital requirements including the use of (partial or full) internal models. Alternatively, supervisors may vary the standardised regulatory capital requirement so that group-specific risks are adequately provided for in the insurance legal entity and/or group capital adequacy assessment.[54]

[54] See Standard 17.9.

17.8.20 Group specific risks should be addressed from both an insurance legal entity perspective and group-wide perspective ensuring that adequate allowance is made. Consideration should be given to the potential for duplication or gaps between insurance legal entity and group-wide approaches.

Diversification of risks between group entities

17.8.21 In the context of a group-wide solvency assessment, there should also be consideration of dependencies and interrelations of risks across different members in the group. However, it does not follow that where diversification effects exist these should be recognised automatically in an assessment of group-wide capital adequacy. It may, for example, be appropriate to limit the extent to which group diversification effects are taken into account for the following reasons:

- Diversification may be difficult to measure at any time and in particular in times of stress. Appropriate aggregation of risks is critical to the proper evaluation of such benefits for solvency purposes.
- There may be constraints on the transfer of diversification benefits across group entities and jurisdictions because of a lack of fungibility of capital or transferability of assets.
- Diversification may be offset by concentration/aggregation effects (if this is not separately addressed in the assessment of group capital).

17.8.22 An assessment of group diversification benefits is necessary under whichever approach used to assess group-wide capital adequacy. Under a legal entity approach, recognition of diversification benefits will require consideration of the diversification between the business of an insurance legal entity and other entities within the group in which it participates and of intra-group transactions. Under an approach with a consolidation focus which uses the consolidated accounts method, some diversification benefits will be recognised automatically at the level of the consolidated group. In this case, supervisors will need to consider whether it is prudent to recognise such benefits or whether an adjustment should be made in respect of potential restrictions on the transferability or sustainability under stress of surplus resources created by group diversification benefits.

Intra-group transactions

17.8.23 Intra-group transactions may result in complex and/or opaque intra-group relationships which give rise to increased risks at both insurance legal entity and group level. In a group-wide context, credit for risk mitigation should only be recognised in group capital requirements to the extent that risk is transferred outside the group. For example, the transfer of risk to a captive reinsurer or to an intra-group insurance special purpose vehicle should not result in a reduction of overall group capital requirements.

Non-insurance group entities

17.8.24 In addition to insurance legal entities, an insurance group may include a range of different types of non-insurance entity, either subject to no financial regulation (non-regulated entities) or regulated under other financial sector regulation. The impact of all such entities should be taken into account in the overall assessment of group-wide solvency but the extent to which they can be captured in a group-wide capital adequacy measure as such will vary according to the type of non-insurance entity, the degree of control/influence on that entity and the approach taken to group-wide supervision.

17.8.25 Risks from non-regulated entities are typically difficult to measure and mitigate. Insurance supervisors may not have direct access to information on such entities but it is important that supervisors are able to assess the risks they pose in order to apply appropriate mitigation measures. Measures taken to address risks from non-regulated entities do not imply active supervision of such entities.

17.8.26 There are different approaches to addressing risks stemming from non-regulated entities such as capital measures, non-capital measures or a combination thereof.

17.8.27 One approach may be to increase capital requirements in order that the group holds sufficient capital. If the activities of the non-regulated entities have similar risk characteristics to insurance activities (e.g. certain credit enhancement mechanisms as compared to traditional bond insurance) it may be possible to calculate an equivalent capital charge. Another approach might be to deduct the value of holdings in non-regulated entities from the capital resources of the insurance legal entities in the group, but this on its own may not be sufficient to cover the risks involved.

17.8.28 Non-capital measures may include, for example, limits on exposures and requirements on risk management and governance applied to insurance legal entities with respect to non-regulated entities within the group.

Cross-jurisdictional entities

17.8.29 Group-wide capital adequacy assessments should, to the extent possible, be based on consistent application of ICPs across jurisdictions. In addition, consideration should be given to the capital adequacy and transferability of assets in entities located in different jurisdictions.

Partial ownership and minority interests

17.8.30 An assessment of group-wide capital adequacy should include an appropriate treatment of partially-owned or controlled group entities and minority interests. Such treatment should take into account the nature of the relationships of the partially-owned entities within the group and the risks and opportunities they bring to the group. The accounting treatment may provide a starting point. Consideration should be given to the availability of any minority interest's share in the net equity in excess of regulatory capital requirements of a partially-owned entity.

Variation of regulatory capital requirements

17.9 Any variations to the regulatory capital requirement imposed by the supervisor are made within a transparent framework, are appropriate to the nature, scale and complexity according to the target criteria and are only expected to be required in limited circumstances.

17.9.1 As has already been noted, a standardised approach, by its very nature, may not be able to fully and appropriately reflect the risk profile of each individual insurer. In cases where the standardised approach established for determining regulatory capital requirements is materially inappropriate for the risk profile of the insurer, the supervisor should have the flexibility to increase the regulatory capital requirement calculated by the standard approach. For example, some insurers using the standard formula may warrant a higher PCR and/or group-wide regulatory capital requirement if they are undertaking higher risks, such as new products where credible experience is not available to establish technical provisions, or if they are undertaking significant risks that are not specifically covered by the regulatory capital requirements.

17.9.2 Similarly, in some circumstances when an approved more tailored approach is used for regulatory capital purposes, it may be appropriate for the supervisor to have some flexibility to increase the capital requirement calculated using that approach. In particular, where an internal model or partial internal model is used for regulatory capital purposes, the supervisor may increase the capital requirement where it considers the internal model does not adequately capture certain risks, until the identified weaknesses have been addressed. This may arise, for example, even though the model has been approved where there has been a change in the business of the insurer and there has been insufficient time to fully reflect this change in the model and for a new model to be approved by the supervisor.

17.9.3 In addition, supervisory requirements may be designed to allow the supervisor to decrease the regulatory capital requirement for an individual insurer where the standardised requirement materially overestimates the capital required according to the target criteria. However, such an approach may require a more intensive use of supervisory resources due to requests from insurers for consideration of a decrease in their regulatory capital requirement. Therefore, the IAIS appreciates that not all jurisdictions may wish to include such an option for their supervisor. Further, this reinforces the need for such variations in regulatory capital requirements to only be expected to be made in limited circumstances.

17.9.4 Any variations made by the supervisor to the regulatory capital requirement calculated by the insurer should be made in a transparent framework and be **appropriate to the nature, scale and complexity** in terms of the target criteria. The supervisor may, for example, develop criteria to be applied in determining such variations and appropriate discussions between the supervisor and the insurer may occur. Variations in regulatory capital requirements following supervisory review from those calculated using standardised approaches or approved more tailored approaches should be expected to be made only in limited circumstances.

17.9.5 In undertaking its ORSA, the insurer considers the extent to which the regulatory capital requirements (in particular, any standardised formula)

adequately reflect its particular risk profile. In this regard, the ORSA undertaken by an insurer can be a useful source of information to the supervisor in reviewing the adequacy of the regulatory capital requirements of the insurer and in assessing the need for variation in those requirements.

Identification of capital resources potentially available for solvency purposes

17.10 The supervisor defines the approach to determining the capital resources eligible to meet regulatory capital requirements and their value, consistent with a total balance sheet approach for solvency assessment and having regard to the quality and suitability of capital elements.

17.10.1 The following outlines a number of approaches a supervisor could use for the determination of capital resources in line with this requirement. The determination of capital resources would generally require the following steps:

- the amount of capital resources potentially available for solvency purposes is identified (see Guidance 17.10.3 - 17.10.21);
- an assessment of the quality and suitability of the capital instruments comprising the total amount of capital resources identified is then carried out (see Guidance 17.11.1 - 17.11.29); and
- on the basis of this assessment, the final capital resources eligible to meet regulatory capital requirements and their value are determined (see Guidance 17.11.30 - 17.11.44).

17.10.2 In addition, the insurer is required to carry out its own assessment of its capital resources to meet regulatory capital requirements and any additional capital needs (see Standard 16.14).

Capital resources under total balance sheet approach

17.10.3 The IAIS supports the use of a total balance sheet approach in the assessment of solvency to recognise the interdependence between assets, liabilities, regulatory capital requirements and capital resources so that risks are appropriately recognised.

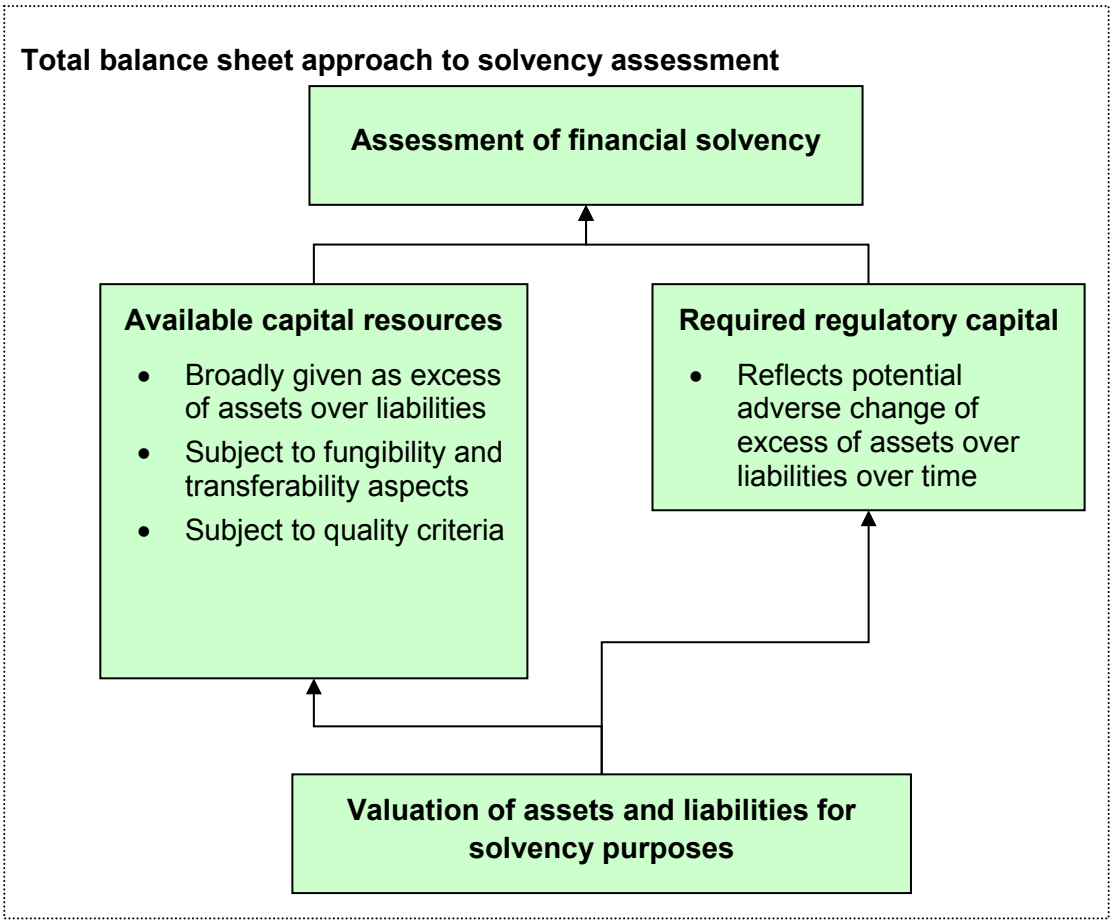
17.10.4 Such an approach requires that the determination of available and required capital is based on consistent assumptions for the recognition and valuation of assets and liabilities for solvency purposes.

17.10.5 From a regulatory perspective, the purpose of regulatory capital requirements is to require that, in adversity, an insurer's obligations to policyholders will continue to be met as they fall due. This aim will be achieved if technical provisions and other liabilities are expected to remain covered by assets over a defined period, to a specified level of safety[55].

[55] Refer to Guidance 17.3.1 - 17.9.5.

17.10.6 To achieve consistency with this economic approach to setting capital requirements in the context of a total balance sheet approach, capital resources should broadly be regarded as the difference between assets and liabilities on the basis of their recognition and valuation for solvency purposes.

Figure 17.4



17.10.7 When regarding available capital resources as the difference between assets and liabilities, the following issues should be considered:

- the extent to which certain liabilities other than technical provisions may be treated as capital for solvency purposes (Guidance 17.10.8 - 17.10.10);
- whether contingent assets could be included (Guidance 17.10.11) ;
- the treatment of assets which may not be fully realisable in the normal course of business or under a wind-up scenario (Guidance 17.10.12 - 17.10.19); and
- reconciliation of such a “top down” approach to determining capital resources with a “bottom up” approach which sums up

individual items of capital to derive the overall amount of capital resources (Guidance 17.10.20).

Treatment of liabilities

17.10.8 Liabilities include technical provisions and other liabilities. Certain items such as other liabilities in the balance sheet may be treated as capital resources for solvency purposes.

17.10.9 For example, perpetual subordinated debt, although usually classified as a liability under the relevant accounting standards, could be classified as a capital resource for solvency purposes.[56] This is because of its availability to act as a buffer to reduce the loss to policyholders and senior creditors through subordination in the event of insolvency. More generally, subordinated debt instruments (whether perpetual or not) may be treated as capital resources for solvency purposes if they satisfy the criteria established by the supervisor. Other liabilities that are not subordinated would not be considered as part of the capital resources; examples include liabilities such as deferred tax liabilities and pension liabilities.

17.10.10 It may, therefore, be appropriate to exclude some elements of funding from liabilities and so include them in capital to the extent appropriate. This would be appropriate if these elements have characteristics which protect policyholders by meeting one or both of the objectives set out in Guidance 17.2.6 above.

Treatment of contingent assets

17.10.11 It may be appropriate to include contingent elements which are not considered as assets under the relevant accounting standards, where the likelihood of payment if needed is sufficiently high according to criteria specified by the supervisor. Such contingent capital may include, for example, letters of credit, members' calls by a mutual insurer or the unpaid element of partly paid capital and may be subject to prior approval by the supervisor.

Treatment of assets which may not be fully realisable on a going-concern or wind-up basis

17.10.12 Supervisors should consider that, for certain assets in the balance sheet, the realisable value under a wind-up scenario may become significantly lower than the economic value which is attributable under going-concern conditions. Similarly, even under normal business conditions, some assets may not be realisable at full economic value, or at any value, at the time they are needed. This may render such assets unsuitable for inclusion at their full economic value for the purpose of meeting required capital.[57]

[56] However, adequate recognition should be given to contractual features of the debt such as embedded options which may change its loss absorbency.

[57] In particular, supervisors should consider the value of contingent assets for solvency purposes taking into account the criteria set out in Guidance 17.11.21.

17.10.13 Examples of such assets include:

- own shares directly held by the insurer: the insurer has bought and is holding its own shares thereby reducing the amount of capital available to absorb losses under going concern or in a wind-up scenario;
- intangible assets: their realisable value may be uncertain even during normal business conditions and may have no significant marketable value in run-off or winding-up; Goodwill is a common example;
- future income tax credits: such credits may only be realisable if there are future taxable profits, which is improbable in the event of insolvency or winding-up;
- implicit accounting assets: under some accounting models, certain items regarding future income are included, implicitly or explicitly, as asset values. In the event of run-off or winding-up, such future income may be reduced;
- investments[58] in other insurers or financial institutions: such investments may have uncertain realisable value because of contagion risk between entities; also there is the risk of "double gearing" where such investments lead to a recognition of the same amount of available capital resources in several financial entities; and
- company-related assets: certain assets carried in the accounting statements of the insurer could lose some of their value in the event of run-off or winding-up, for example physical assets used by the insurer in conducting its business which may reduce in value if there is a need for the forced sale of such assets. Also, certain assets may not be fully accessible to the insurer e.g. surplus in a corporate pension arrangement.

17.10.14 The treatment of such assets for capital adequacy purposes may need to reflect an adjustment to its economic value. Generally, such an adjustment may be effected either:

- directly, by not admitting a portion of the economic value of the asset for solvency purposes (deduction approach); or
- indirectly, through an addition to regulatory capital requirements (capital charge approach).

Deduction approach

17.10.15 Under the deduction approach, the economic value of the asset is reduced for solvency purposes. This results in capital resources being reduced by the same amount. The partial (or full) exclusion of such an asset may occur for a variety of reasons, for example, to reflect an expectation that it would have only limited value in the event of insolvency or winding-up to absorb losses. No further adjustment would normally be

[58] These investments include investment in the equity of, loans granted to, deposits with and bonds issued by the related parties.

needed in the determination of regulatory capital requirements for the risk of holding such assets.

Capital charge approach

17.10.16 Under the capital charge approach, an economic value is placed on the asset for the purpose of determining available capital resources. The risk associated with the asset – i.e. a potential deterioration of the economic value of the asset due to an adverse event which may occur during the defined solvency time horizon - would then need to be reflected in the determination of regulatory capital requirements. This should take into account the estimation uncertainty[59] inherent in the determination of the economic value.

Choice and combination of approaches

17.10.17 As outlined above, an application of the deduction approach would lead to a reduction in the amount of available capital resources, whereas an application of the capital charge approach would result in an increase in regulatory capital requirements. Provided the two approaches are based on a consistent economic assessment of the risk associated with the relevant assets, they would be expected to produce broadly similar results regarding the overall assessment of the solvency position of the insurer.

17.10.18 For some asset classes, it may be difficult to determine a sufficiently reliable economic value or to assess the associated risks. Such difficulties may also arise where there is a high concentration of exposure to a particular asset or type of assets or to a particular counterparty or group of counterparties.

17.10.19 A supervisor should choose the approach which is best suited to the organisation and sophistication of the insurance sector and the nature of the asset class and asset exposure considered. It may also combine different approaches for different classes of assets. Whatever approach is chosen, it should be transparent and consistently applied. It is also important that any material double counting or omission of risks under the calculations for determining the amounts of required and available regulatory capital is avoided.

Reconciliation of approaches

17.10.20 The approach to determining available capital resources as broadly the amount of assets over liabilities (with the potential adjustments as discussed above) may be described as a "top-down" approach - i.e. starting with the high level capital as reported in the balance sheet and adjusting it in the context of the relevant solvency control level. An alternative approach which is also applied in practice is to sum up the amounts of particular items of capital which are specified as being

[59] This refers to the degree of inaccuracy and imprecision in the determination of the economic value where observable values are not available, and estimation methodologies need to be applied. Sources for this estimation uncertainty are for example the possibility that the assumptions and parameters used in the valuation are incorrect, or that the valuation methodology itself is deficient.

acceptable. Such a "bottom-up" approach should be reconcilable to the "top-down" approach on the basis that the allowable capital items under the "bottom-up approach" should ordinarily include all items which contribute to the excess of assets over liabilities in the balance sheet, with the addition or exclusion of items as per the discussion in Guidance 17.10.8 - 17.10.19.

Other considerations

17.10.21 A number of factors may be considered by the supervisor in identifying what may be regarded as capital resources for solvency purposes, including the following:

- the way in which the quality of capital resources is addressed by the supervisor, including whether or not quantitative requirements are applied to the composition of capital resources and/or whether or not a categorisation or continuum- based approach is used;
- the coverage of risks in the determination of technical provisions and regulatory capital requirements;
- the assumptions in the valuation of assets and liabilities (including technical provisions) and the determination of regulatory capital requirements, e.g. going-concern basis or wind-up basis, before tax or after tax, etc;
- policyholder priority and status under the legal framework relative to other creditors in the jurisdiction;
- overall quality of risk management and governance frameworks in the insurance sector in the jurisdiction;
- the comprehensiveness and transparency of disclosure frameworks in the jurisdiction and the ability for markets to exercise sufficient scrutiny and impose market discipline;
- the development of the capital market in the jurisdiction and its impact on the ability of insurers to raise capital;
- the balance to be struck between protecting policyholders and the impact on the effective operation of the insurance sector and considerations around unduly onerous levels and costs of regulatory capital requirements;
- the relationship between risks faced by insurers and those faced by other financial services entities, including banks.

Additional guidance for insurance groups and insurance legal entities that are members of groups

17.10.22 The considerations set out in Guidance 17.10.3 - 17.10.21 above apply equally to insurance legal entity and group-wide supervision. The practical application of these considerations will differ according to whether a legal entity focus or a group level focus is taken to group-wide supervision. Whichever approach is taken, key group-wide factors to be

addressed in the determination of group-wide capital resources include multiple gearing, intra-group creation of capital and reciprocal financing, leverage of the quality of capital and fungibility of capital and free transferability of assets across group entities. There may be particular concerns where such factors involve less transparent transactions e.g. because they involve both regulated and non-regulated entities or where there is a continuous sequence of internal financing within the group, or closed loops in the financing of the group.

Criteria for the assessment of the quality and suitability of capital resources

17.11 The supervisor establishes criteria for assessing the quality and suitability of capital resources, having regard to their ability to absorb losses on both a going-concern and wind-up basis.

17.11.1 In view of the two objectives of capital resources set out in Guidance 17.2.6, the following questions need to be considered when establishing criteria to determine the suitability of capital resources for regulatory purposes:

- To what extent can the capital element be used to absorb losses on a going-concern basis or in run-off?
- To what extent can the capital element be used to reduce the loss to policyholders in the event of insolvency or winding-up?

17.11.2 Some capital elements are available to absorb losses in all circumstances i.e. on a going concern basis, in run-off, in winding-up and insolvency. For example, common shareholders' funds (ordinary shares and reserves) allow an insurer to absorb losses on an ongoing basis, are permanently available and rank as the most subordinate instruments in a winding-up. Further, this element of capital best allows insurers to conserve resources when they are under stress because it provides an insurer with full discretion as to the amount and timing of distributions. Consequently, common shareholders' funds are a core element of capital resources for the purpose of solvency assessment.

17.11.3 The extent of loss absorbency of other capital elements can vary considerably. Hence, a supervisor should take a holistic approach to evaluating the extent of loss absorbency overall and should establish criteria that should be applied to evaluate capital elements in this regard, taking into account empirical evidence that capital elements have absorbed losses in practice, where available.

17.11.4 To complement the structure of regulatory capital requirements, the supervisor may choose to vary the criteria for capital resources suitable for covering the different solvency control levels established by the supervisor. Where such an approach is chosen, the criteria relating to capital resources suitable for covering an individual control level should have regard to the supervisory intervention that may arise if the level is breached and the objective of policyholder protection.

17.11.5 For example, considering that the main aim of the MCR is to provide the ultimate safety net for the protection of the interests of policyholders, the supervisor may decide to establish more stringent quality criteria for capital resources suitable to cover the MCR (regarding such resources

as a “last line of defence” for the insurer both during normal times and in wind-up) than for capital resources to cover the PCR.

17.11.6 Alternatively, a common set of regulatory criteria for capital resources could be applied at all solvency control levels, with regulatory capital requirements reflecting the different nature of the various solvency control levels.

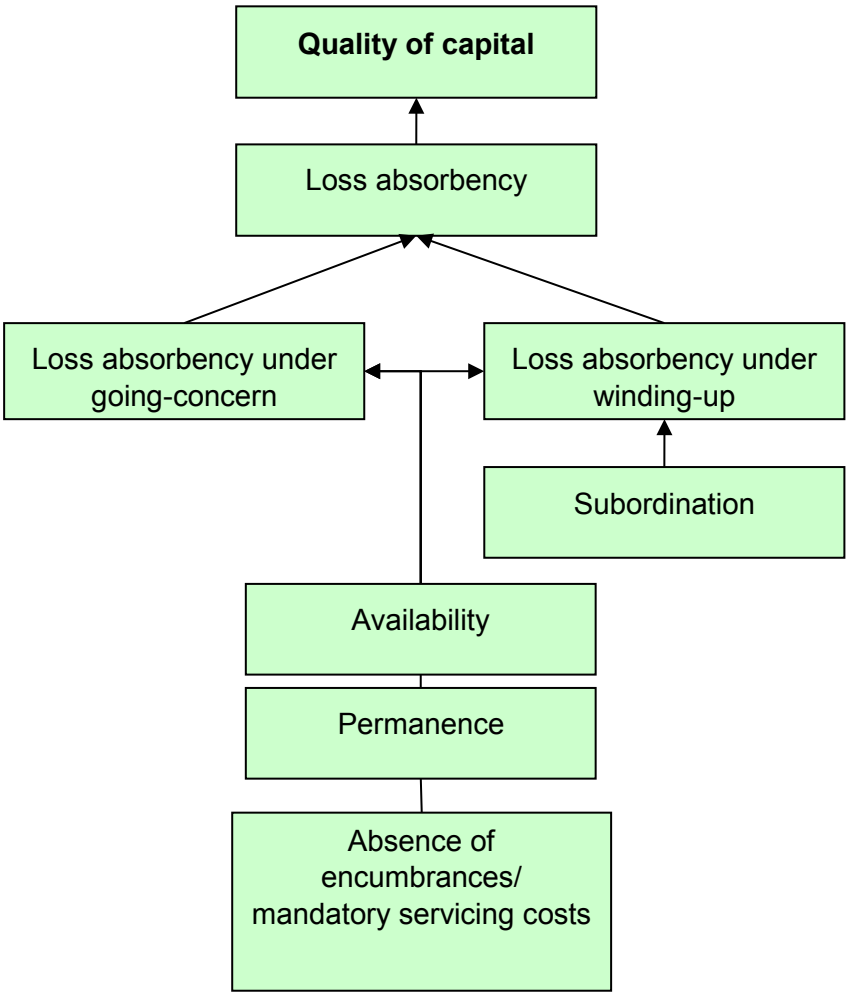
17.11.7 In assessing the ability of elements of capital to absorb losses, the following characteristics are usually considered:

- the extent to which and in what circumstances the capital element is subordinated to the rights of policyholders in an insolvency or winding-up (subordination);
- The extent to which the capital element is fully paid and available to absorb losses (availability);
- the period for which the capital element is available (permanence); and
- the extent to which the capital element is free from mandatory payments or encumbrances (absence of encumbrances and mandatory servicing costs).

17.11.8 In the first bullet of Guidance 17.11.7 above, this characteristic is inherently linked to the ability of the capital item to absorb losses in the event of insolvency or winding-up. The characteristics of permanence and availability are relevant for loss absorbency under both going-concern and winding-up; taken together, they could be described as being able to absorb losses when needed. The fourth characteristic is related to the degree to which the capital is conserved until needed, and in the case of absence of mandatory serving costs is primarily relevant for ensuring loss absorbency on a going-concern basis.

17.11.9 The relationship between these characteristics is illustrated below:

Figure 17.5



17.11.10 In the following Guidance, we examine how the characteristics of capital resources described above may be used to establish criteria for an assessment of the quality of capital elements for regulatory purposes. It is recognised that views about the specific characteristics that are acceptable may differ from jurisdiction to jurisdiction and will reflect, amongst other things, the extent to which the pre-conditions for effective supervision exist within the jurisdiction and the risk tolerance of the particular supervisor.

Subordination

17.11.11 To require that a capital element is available to protect policyholders, it must be legally subordinated to the rights of policyholders and senior creditors of the insurer in an insolvency or winding-up. This means that the holder of a capital instrument is not entitled to repayment, dividends or interest once insolvency or winding-up proceedings have been started until all obligations to the insurer's policyholders have been satisfied.

17.11.12 In addition, there should be no encumbrances that undermine the subordination or render it ineffective. One example of this would be applying rights of offset where creditors are able to set off amounts they owe the insurer against the subordinated capital instrument[60]. Further, the instrument should not be guaranteed by either the insurer or another related entity unless it is clear that the guarantee is available subject to the policyholder priority. In some jurisdictions subordination to other creditors may also need to be taken into account.

17.11.13 Each jurisdiction is governed by its own laws regarding insolvency and winding-up. Common equity shareholders normally have the lowest priority in any liquidating distribution of assets, immediately following preferred shareholders. In some jurisdictions, insurers can issue subordinated debt that provides protection to policyholders and creditors in insolvency. While policyholders are often given a legal priority above other creditors such as bondholders, this is not always the case; some jurisdictions treat policyholders and other creditors equally. Some jurisdictions rank obligations to the government (e.g. taxes) and obligations to employees, ahead of policyholders and other creditors. Where creditors have secured claims, they may rank before policyholders. The determination of suitable capital elements for solvency purposes is critically dependent upon the legal environment of the relevant jurisdiction.

17.11.14 The supervisor should evaluate each potential capital element in the context that its value and suitability, and hence an insurer's solvency position may change significantly in a wind-up or insolvency scenario. In most jurisdictions the payment priority in a wind-up situation is clearly stated in law.

Availability

17.11.15 In order to satisfy the primary requirement that capital resources are available to absorb unforeseen losses, it is important that capital elements are fully paid.

17.11.16 However, in some circumstances, a capital element may be paid for "in kind" i.e. issued for non-cash. The supervisor should define the extent to which payment other than cash is acceptable for a capital element to be treated as fully paid without prior approval by the supervisor and the circumstances where payment for non-cash consideration may be considered as suitable subject to approval by the supervisor. There may, for example, be issues about the valuation of the non-cash components or the interests of parties other than the insurer.

17.11.17 It may also be appropriate to treat certain contingent elements of capital as available capital resources in cases where the probability of payment is expected to be sufficiently high (for example, the unpaid part of partly paid capital, contributions from members of a mutual insurer or letters of credit, see Guidance 17.10.11).

17.11.18 Where a supervisor allows contingent elements of capital to be included in the determination of capital resources, such inclusion would be

[60] Rights of offset will vary according to the legal environment in a jurisdiction.

expected to be subject to meeting specific supervisory requirements or prior supervisory approval. When assessing the appropriateness of inclusion of a contingent element of capital, regard should be had to:

- the ability and willingness of the counterparty concerned to pay the relevant amount;
- the recoverability of the funds, taking into account any conditions which would prevent the item from being successfully paid in or called up; and
- any information on the outcome of past calls which have been made in comparable circumstances by other insurers, which may be used as an indication of future availability.

17.11.19 The availability of capital instruments may also be impaired when capital is not fully fungible within an insurer to cover losses arising from the insurer's business. Whereas the fungibility of capital and transferability of assets is primarily an issue in the context of group solvency assessment, it may also be relevant for the supervision of an insurer as a legal entity.

17.11.20 For example, this is the case where – as applies to certain forms of with-profit business in life insurance – part of the assets or surplus of the insurer is segregated from the rest of its operations in a ring-fenced fund. In such cases, assets in the fund may only be able to be used to meet obligations to policyholders with respect to which the fund has been established. In these circumstances, the insurer's available capital resources relating to the ring-fenced fund can only be used to cover losses stemming from risks associated with the fund (until transferred out of that fund) and cannot be transferred to meet the insurer's other obligations.

Permanence

17.11.21 To provide suitable protection for policyholders for solvency purposes, a capital element must be available to protect against losses for a sufficiently long period to ensure that it is available to the insurer when needed. Supervisors may want to determine a minimum period that capital should be outstanding to be regarded as capital resources for solvency purposes.

17.11.22 When assessing the extent of permanence of a capital element, regard should be had to:

- the duration of the insurer's obligations to policyholders;[61]
- contractual features of the capital instrument which have an effect on the period for which the capital is available, e.g. lock-in clauses, step-up options or call options;
- any supervisory powers to restrict the redemption of capital resources; and

[61] The duration of the insurer's obligations to policyholders should be assessed on an economic basis rather than strict contractual basis.

- the time it might take to replace the capital element on suitable terms as it approaches maturity.

17.11.23 Similarly, if a capital element has no fixed maturity date, the notice required for repayment should be assessed against the same criteria.

17.11.24 It is important to take into account incentives to redeem a capital element prior to its maturity date which may exist in a capital element and may effectively reduce the period for which the capital is available. For example, a capital instrument which features a coupon rate which increases from its initial level at a specified date after issue, may give rise to an expectation that the instrument will be paid back at that future specified date.

Absence from mandatory servicing requirements or encumbrances

17.11.25 The extent to which capital elements require servicing in the form of interest payments, shareholder dividend payments and principal repayments should be considered, as it will affect the insurer's ability to absorb losses on a going-concern basis.

17.11.26 Capital elements that have a fixed maturity date may have fixed servicing costs that cannot be waived or deferred before maturity. The presence of such features also affects the insurer's ability to absorb losses on a going-concern basis and may accelerate insolvency if the payment of a servicing cost results in the insurer breaching its regulatory capital requirements.

17.11.27 A further consideration is the extent to which payments to capital providers or redemption of capital elements should be restricted or subject to supervisory approval. For example, the supervisor may have the ability to restrict the payment of dividends or interest and any redemption of capital resources where considered appropriate to preserve the solvency position of the insurer. Insurers may also issue capital instruments for which payments and redemptions are fully discretionary or subject to supervisory approval according to the contractual terms.

17.11.28 Some capital instruments are structured so as to restrict the payment of dividends or interest and any redemption of capital resources where an insurer is breaching or near to breaching its regulatory capital requirements and/or is incurring loss. The payment of dividends or interest may also be subordinated to policyholder interests in case of winding-up or insolvency. Such features will contribute to the ability of the capital instrument to absorb losses on a wind-up basis provided that any claims to unpaid dividends or interest are similarly subordinated.

17.11.29 It should also be considered whether the capital elements contain encumbrances which may restrict their ability to absorb losses, such as guarantees of payment to the capital provider or other third parties, hypothecation or any other restrictions or charges which may prevent the insurer from using the capital resource when needed. Where the capital element includes guarantees of payment to the capital provider or other third parties, the priority of that guarantee in relation to policyholders'

rights should be assessed. Encumbrances may also undermine other characteristics such as permanence or availability of capital.

Determination of capital resources to meet regulatory capital requirements

17.11.30 Based on the assessment of the quality of the capital elements comprising the total capital resources potentially available to the insurer, the final capital resources suitable to meet the regulatory capital requirements can be determined.

17.11.31 Capital elements that are fully loss absorbent under both a going-concern and a wind-up perspective would generally be allowed to cover any of the different levels of regulatory capital requirements. However, the supervisor may choose to restrict the extent to which the stronger solvency control levels (i.e. control levels which trigger more severe supervisory interventions) may be covered by lower quality capital resources or to establish minimum levels for the extent to which these stronger requirements should be covered by the highest quality capital resources. In particular, this applies to amounts of capital resources which are intended to cover the MCR.

17.11.32 To determine the amount of an insurer's capital resources, supervisors may choose a variety of approaches:

- approaches which categorise capital resources into different quality classes ("tiers") and apply certain limits/restrictions with respect to these tiers (tiering approaches);
- approaches which rank capital elements on the basis of the identified quality characteristics (continuum-based approaches); or
- approaches which do not attempt to categorise or rank capital elements, but apply individual restrictions or charges where necessary.

To accommodate the quality of assets and quality of capital elements, combinations of the above approaches have been widely used in various jurisdictions for solvency purposes for insurance and other financial sectors.

Determination of capital resources to meet regulatory capital requirements - tiering approach

17.11.33 To take into account the quality of capital instruments, a tiering approach is commonly used in many jurisdictions and in other financial sectors. Under a tiering approach, the composition of capital resources is based on the categorisation of elements of capital according to the quality criteria set by the supervisor.

17.11.34 In many jurisdictions, capital elements are categorised into two or three distinct levels of quality when considering criteria for, and limits on, those

capital elements for solvency purposes. For example, one broad categorisation may be as follows;[62]

- Highest quality capital - permanent capital that is fully available to cover losses of the insurer at all times on a going-concern and a wind-up basis;
- Medium quality capital - capital that lacks some of the characteristics of highest quality capital, but which provides a degree of loss absorbency during ongoing operations and is subordinated to the rights (and reasonable expectations) of policyholders; and
- Lowest quality capital - capital that provides loss absorbency in insolvency/ winding-up only.

17.11.35 Under a tiering approach, the supervisor would set minimum or upper levels for the extent to which required capital should comprise the various categories or tiers (for example, high, medium, low) of capital elements. Where established, the level may be expressed as a percentage of required capital[63] (for example, a minimum level of 50%[64] of required capital for high quality capital elements and/or an upper limit for lowest quality capital might be 25% of required regulatory capital). There may also be limits set on the extent to which required capital may be comprised of certain specific types of capital elements (for example, perpetual subordinated loan capital and perpetual cumulative preference share capital may be limited to 50% of required capital.)

17.11.36 What constitutes an adequate minimum or upper level may depend on the nature of the insurance business and how the requirement interacts with the various solvency control levels. A separation into tiers as set out above assumes that all elements of capital can clearly be identified as belonging to one of the specified tiers and that elements falling into an individual tier will all be of the same quality. In reality, such distinctions between elements of capital may not be clear cut and different elements of capital will exhibit the above quality characteristics in varying degrees.

17.11.37 There are two potential policy responses to this fact. One is to set minimum quality thresholds on the characteristics the capital must have to be included in the relevant tier - as long as these thresholds are met for a given element then it can be included in the relevant tier of capital without limit. The other approach is to set minimum quality thresholds for limited inclusion in the relevant tier, but to set additional higher quality thresholds for elements to be permitted to be included in that tier without limit. This approach effectively sub-divides the tiers. It permits greater recognition within a given tier for elements of capital which are more likely to fulfil the quality targets specified for that tier.

17.11.38 Where a tiering approach is applied, this should ideally follow the distinction between going-concern capital and wind-up capital. Dividing

[62] Capital elements categorised as being of highest quality are often referred to as core capital and lower levels as supplementary capital, or similar.

[63] Alternative approaches may also be used in practice, for example, where the levels are expressed as a percentage of available capital.

[64] The percentages used may vary for supervisors in different jurisdictions

capital into these tiers is an approach that is also used in the context of regulatory capital requirements for the banking sector.

Determination of capital resources to meet regulatory capital requirements – continuum-based approach

17.11.39 In other jurisdictions a continuum-based approach may be used in recognising the differential quality of capital elements. Under this approach, elements of capital are not categorised, but rather ranked, relative to other elements of capital on the basis of identified quality characteristics set by the supervisor. The supervisor also defines the minimum acceptable level of quality of capital for solvency purposes and perhaps for different solvency control levels. In this way the capital elements are classified from highest to lowest quality on a continuous basis; only capital elements sitting above this defined minimum level on the continuum, would be accepted as capital resources for solvency purposes. Due consideration should again be given to the quality of capital elements to ensure that there is an appropriate balance of going-concern and wind-up capital.

Determination of capital resources to meet regulatory capital requirements - other approaches on determination of capital resources

17.11.40 The supervisor may also apply approaches that are not based on an explicit categorisation of capital instruments, but more on an assessment of the quality of individual capital instruments and their specific features. For example, the terms of a hybrid capital instrument may not provide enough certainty that coupon payments will be deferred in times of stress. In such a case, the supervisor's approach may limit (possibly taking into account further quality criteria) the ability of that instrument to cover the regulatory capital requirements.

Determination of capital resources to meet regulatory capital requirements - choice and combination of approaches

17.11.41 Each approach has advantages and disadvantages. Jurisdictions should consider the organisation and sophistication of the insurance sector and choose the best approach appropriate to the circumstances. Whatever approach is used overall, it should be transparent and be consistently applied so that capital resources are of sufficient quality on a going-concern and a wind-up basis.

17.11.42 It is recognised that in some markets, only a limited range of instruments (for example, pure equity) may meet the quality criteria set out above. Accordingly, supervisors in such markets may wish to restrict the range of instruments that may be included in capital resources for solvency purposes or to apply procedures for prior approval as appropriate.

17.11.43 It is also important that the approach to the determination of capital resources for solvency purposes is consistent with the framework and principles underlying the determination of regulatory capital requirements. This includes not only the implemented range of solvency control levels but is also relevant with regard to the target criteria

underlying the regulatory capital requirements. In particular, the target criteria for regulatory capital requirements and hence the approach to determining capital resources should be consistent with the way in which the supervisor addresses the two broad aims of capital from a regulatory perspective as described in Guidance 17.2.6.

17.11.44 To illustrate this, suppose that in setting regulatory capital requirements the supervisor would consider the maximum probability over a specified time period with which they are willing to let unforeseen losses cause the insolvency of an insurer. In such a case, insurers would need to maintain sufficient capital resources to absorb losses before insolvency or winding-up occurs. Hence the determination of capital resources would need to lay sufficient emphasis on the first objective stated in Guidance 17.2.6 (loss absorbency under going concern), and could not entirely rely on the second objective (loss absorbency solely under insolvency or winding-up).

Additional guidance for insurance groups and insurance legal entities that are members of groups

17.11.45 The considerations set out in Guidance 17.11.1 - 17.11.44 above apply equally to insurance legal entity and group-wide supervision. See Guidance 17.10.22 for additional guidance on the criteria for the assessment of the quality and suitability of capital resources for insurance groups and insurance legal entities that are members of groups.

Multiple gearing and intra-group creation of capital

17.11.46 Double gearing may occur if an insurer invests in a capital instrument that counts as regulatory capital of its subsidiary, its parent or another group entity. Multiple gearing may occur if a series of such transactions exist.

17.11.47 Intra-group creation of capital may arise from reciprocal financing between members of a group. Reciprocal financing may occur if an insurance legal entity holds shares in or makes loans to another legal entity (either an insurance legal entity or otherwise) which, directly or indirectly, holds a capital instrument that counts as regulatory capital of the first insurance legal entity.

17.11.48 For group-wide capital adequacy assessment with a group level focus, a consolidated accounts method would normally eliminate intra-group transactions and consequently multiple gearing and other intra-group creation of capital whereas, without appropriate adjustment, a legal entity focus may not. Whatever approach is used, multiple gearing and other intra-group creation of capital should be identified and treated in a manner deemed appropriate by the supervisor to largely prevent the duplicative use of capital.

Leverage

17.11.49 Leverage arises where a parent, either a regulated company or an unregulated holding company, issues debt or other instruments which are ineligible as regulatory capital or the eligibility of which is restricted and down-streams the proceeds as regulatory capital to a subsidiary.

Depending on the degree of leverage, this may give rise to the risk that undue stress is placed on a regulated entity as a result of the obligation on the parent to service its debt.

Fungibility and transferability

17.11.50 In the context of a group-wide solvency assessment, excess capital in an insurance legal entity above the level needed to cover its own capital requirements may not always be available to cover losses or capital requirements in other insurance legal entities in the group. Free transfer of assets and capital may be restricted by either operational or legal limitations. Some examples of such legal restrictions are exchange controls in some jurisdictions, surpluses in with-profits funds of life insurers which are earmarked for the benefit of policyholders and rights that holders of certain instruments may have over the assets of the legal entity. In normal conditions, surplus capital at the top of a group can be down-streamed to cover losses in group entities lower down the chain. However, in times of stress such parental support may not always be forthcoming or permitted.

17.11.51 The group-wide capital adequacy assessment should identify and appropriately address restrictions on the fungibility of capital and transferability of assets within the group in both "normal" and "stress" conditions. A legal entity approach which identifies the location of capital and takes into account legally enforceable intra-group risk and capital transfer instruments may facilitate the accurate identification of, and provision for, restricted availability of funds. Conversely an approach with a consolidation focus using a consolidated accounts method which starts by assuming that capital and assets are readily fungible/transferable around the group will need to be adjusted to provide for the restricted availability of funds.

General provisions on the use of an internal model to determine regulatory capital requirements

17.12 Where a supervisor allows the use of internal models to determine regulatory capital requirements, the supervisor:

- **establishes appropriate modelling criteria to be used for the determination of regulatory capital requirements, which require broad consistency among all insurers within the jurisdiction; and**
- **identifies the different levels of regulatory capital requirements for which the use of internal models is allowed.**

17.12.1 Internal models can be considered in the dual contexts of:

- a method by which an insurer determines its own economic capital[65] needs; and
- a means to determine an insurer's regulatory capital resources and requirements, where appropriate.

[65] Economic capital refers to the capital which results from an economic assessment of the insurer's risks given the insurer's risk tolerance and business plans.

In either case, the quality of the insurer's risk management and governance is vital to the effective use of internal models. If the insurer has supervisory approval, internal models can be used to determine the amount of the insurer's regulatory capital requirements. However, an insurer should not need supervisory approval, initial or ongoing, for the use of its internal model in determining its own economic capital needs or management.

17.12.2 One of the main purposes of an internal model is to better integrate the processes of risk and capital management within the insurer. Among other uses, internal models can be used to determine the economic capital needed by the insurer and, if an insurer has supervisory approval, to determine the amount of the insurer's regulatory capital requirements. As a basic principle, an internal model that is to be used for regulatory capital purposes should already be in established use for determining economic capital. The methodologies and assumptions used for the two purposes should be consistent, any differences being explainable in terms of the difference in purposes.

17.12.3 Where the supervisor allows a range of standardised and more tailored approaches for regulatory capital purposes, including internal models, an insurer should have a choice as to which approach it adopts,[66] subject to satisfying certain conditions established by the supervisor on the use of internal models for regulatory capital purposes.

17.12.4 Where there is a choice of approach allowed by a supervisor, it is inappropriate for an insurer to be able to adopt a process of "cherry-picking" between those approaches[67] – for example, by choosing to use its model for regulatory capital purposes only when the model results in a lower capital requirement than a standardised approach. The IAIS supports the use of internal models where appropriate as they can be a more realistic, risk-responsive method of calculating capital requirements, but discourages any "cherry-picking" practices by insurers.

17.12.5 In particular, where the risk profile of an insurer which is using a standardised approach for calculating its regulatory capital requirements is such that the assumptions underlying this approach are inappropriate, the supervisor may use its powers to increase the insurer's capital requirement, or to require the insurer to reduce the risks it bears. However, in such circumstances the supervisor should also consider encouraging the insurer to develop a full or partial internal model which might enable its risk profile to be better reflected in its regulatory capital requirements.

17.12.6 Where the supervisor is aware that an insurer has an existing internal model but has not sought approval to use it to calculate the regulatory capital requirement, the supervisor should discuss this decision with the insurer.

[66] There are a number of considerations that the insurer would also have to make before deciding to invest in constructing an internal model, one of which is cost. The IAIS is not advocating that all insurers must have an internal model (although their use is encouraged where appropriate).

[67] Refer to Guidance 17.12.14 in relation to "cherry-picking" in the particular context of partial internal models.

17.12.7 Effective use of internal models by an insurer for regulatory capital purposes should lead to a better alignment of risk and capital management by providing incentives for insurers to adopt better risk management procedures which can:

- produce regulatory capital requirements that are more risk sensitive and better reflect the supervisor's target criteria; and
- assist the integration of the internal model fully into the insurer's strategic, operational and governance processes, systems and controls.

Criteria for the use of an internal model to determine an insurer's regulatory capital requirements

17.12.8 Where a supervisor allows the use of internal models to determine regulatory capital requirements, the supervisor should determine modelling criteria, based upon the level of safety required by the supervisor, to be used by an insurer adopting an internal model for that purpose. These criteria should require broad consistency between all insurers within the jurisdiction being based on the same broad level of safety requirements applied to the overall design and calibration of the standardised approach to determining regulatory capital requirements. Discussions with the insurance industry in a jurisdiction may also assist in achieving consistency. The supervisor should set out for which of the different levels of regulatory capital requirements the use of internal models is allowed and determine the modelling criteria for each level.

17.12.9 In particular, when considering whether an internal model may be used in determining the MCR, the supervisor should take into account the main objective of the MCR (i.e. to provide the ultimate safety net for the protection of policyholders) and the ability of the MCR to be defined in a sufficiently objective and appropriate manner to be enforceable. If internal models are allowed for determining the MCR, particular care should be taken so that the strongest supervisory action that may be necessary if the MCR is breached can be enforced, for example if the internal model is challenged in a court of law.

17.12.10 The IAIS does not prescribe specific solvency requirements which are compulsory to all IAIS members. Notwithstanding this, the supervisor will need to establish the appropriate modelling criteria to be used by insurers to meet its regulatory capital requirements, and the insurer's internal models will need to be calibrated accordingly if used for that purpose. The IAIS notes that some supervisors who allow the use of internal models to determine regulatory capital requirements have set a confidence level for regulatory purposes, which is comparable with a minimum investment grade level. Some examples of modelling criteria include a 99.5% VaR[68]

[68] VaR – Value at Risk – an estimate of the worst expected loss over a certain period of time at a given confidence level.

calibrated confidence level over a one year timeframe,[69] a 99% TVaR[70] over one year[71] and a 95% TVaR over the term of the policy obligations. Different criteria apply for PCR and MCR.

17.12.11 If an internal model is used for regulatory capital purposes, the insurer should ensure that its regulatory capital requirements determined by the model are calculated in a way that is consistent with the objectives, principles and criteria used by the supervisor. For example, the insurer may be able to apply the confidence level specified in the supervisors' modelling criteria directly to the probability distribution forecasts used in its internal model. Alternatively, depending on the insurer's own modelling criteria for its economic capital, an insurer may have to recalibrate its internal model to the modelling criteria required by the supervisor in order to use it for regulatory capital purposes. This will allow internal models to have a degree of comparability to enable supervisors to make a meaningful assessment of an insurer's capital adequacy, without sacrificing the flexibility needed to make it a useful internal capital model in the operation of the insurer's business. Further elaboration is provided in Guidance 17.15.1 - 17.15.2.

17.12.12 It is noted that, due to the insurer-specific nature of each internal model, internal models can be very different from each other. Supervisors, in allowing the use of an internal model for regulatory capital purposes, should preserve broad consistency of capital requirements between insurers with broadly similar risks.

Partial internal models

17.12.13 The IAIS supports the use of partial internal models for regulatory capital purposes, where appropriate. A partial internal model typically involves the use of internal modelling to substitute parts of a standardised approach for the determination of regulatory capital requirements. For example, an insurer could decide to categorise its insurance contracts along business lines for modelling purposes. If the regulatory capital requirements for some of these categories are determined by modelling techniques, while the capital requirements for other categories are determined using a standardised approach, then this would constitute the insurer using a partial internal model to calculate regulatory capital.

17.12.14 Partial internal models are often used to smooth an insurer's transition to full use of an internal model or to deal with instances such as the merger of two insurers, one of which uses an internal model, and the other which uses a standardised approach. Given the potential complexity of a full internal model, use of a partial internal model could be a satisfactory approach provided its scope is properly defined (and approved by the supervisor). Provided the reduced scope of the internal model is soundly justified, the use of a partial internal model could be allowed as a

[69] This is the level expected in Australia for those insurers that seek approval to use an internal model to determine their MCR. It is also the level used for the calculation of the risk-based Solvency Capital Requirement under the European Solvency II regime.

[70] TVaR – Tail Value at Risk – the VaR plus the average exceedence over the VaR if such exceedence occurs

[71] These are the modelling criteria of the Swiss Solvency Test.

permanent solution. However, as discussed above, there could be a tendency for an insurer to adopt a "cherry-picking" approach in the use of internal models. This particularly applies where partial modelling is allowed. The supervisor should place the onus on the insurer to justify why it has chosen to only use internal models for certain risks or business lines. Where this justification is not sound enough, the supervisor should take appropriate action e.g. refuse or withdraw approval of the model or impose a capital add-on until the model has developed to a sufficient degree.

17.12.15 This ICP should be applied to both partial and full internal models. Partial models should therefore be subject, as appropriate, to the full range of tests: the "statistical quality test", "calibration test" and "use test" (see Guidance 17.13.1 - 17.17.8). In particular, an insurer should assess how the partial internal model achieves consistency with the modelling criteria specified by the supervisor for regulatory purposes. As part of the approval process for regulatory capital use, an insurer should be required to justify the limited scope of the model and why it considers that using partial internal modelling for determining regulatory capital requirements is more consistent with the risk profile of the business than the standardised approach or why it sufficiently matches regulatory capital requirements. The insurer should clearly document the reasons behind its decision to use partial internal models. If, for example, this is to ease transition towards full internal models, the insurer should outline a transitional plan, considering the implications for risk and capital management of the transition. Such plans and use of partial internal models should be reviewed by the supervisor, who may decide to impose certain restrictions on the partial model's use for calculating regulatory capital (for example, introducing a capital add-on during the transitional period).

Additional guidance for group-wide internal models

17.12.16 Where a supervisor allows the use of group-wide internal models[72] to determine regulatory capital requirements, the supervisor should determine modelling criteria for such models, based upon the level of safety required by the supervisor applicable to an insurance group or an insurance legal entity adopting an internal model for that purpose.

17.12.17 The modelling criteria for internal models for regulatory capital purposes and the process for internal model approval that a supervisor establishes should require broad consistency between group-wide regulatory capital requirements and regulatory capital requirements of individual insurance legal entities.

[72] A group-wide internal model is a risk measurement system a group uses for its internal purposes to analyse and quantify risks to the group as a whole as well as risks to the various parts of the group, to determine the capital resources needed to cover those risks and to allocate capital resources across the group. Group-wide internal models include partial models which capture a subset of the risks to the group and/or all the risks of a subset of the group. Group-wide internal models also include combinations of models in respect of different parts of the group. An insurer's internal model may be part of a broader group-wide model rather than a standalone model.

17.12.18 Group-wide internal models can vary greatly depending on their group-specific nature. In allowing the use of group-wide internal models for regulatory capital purposes, supervisors should preserve broad consistency between insurance groups and insurers with broadly similar risks e.g. insurance legal entities and insurance groups operating through a branch structure in a jurisdiction. The supervisor should design modelling criteria and the process for model approval so as to maintain broad consistency between the regulatory capital requirements determined using internal models and standardised approaches.

17.12.19 The IAIS recognises that modelling criteria may differ among supervisors. For Insurance groups operating in multiple jurisdictions, the degree of consistency in regulatory capital requirements across group members may vary.

17.12.20 Each supervisor should set out for which group-wide regulatory capital requirements, corresponding to the solvency control level or levels which apply to an insurance group, the use of group-wide internal models is allowed.

17.12.21 In particular, when the supervisor considers allowing the use of internal models for the purpose of determining group-wide regulatory capital requirements at the MCR level, the issues relating to possible legal challenges may differ from those encountered in respect of individual insurance legal entities. For example, supervisors may need to work together to establish and co-ordinate grounds for legal action in respect of the different insurance legal entities within a group.

Initial validation and supervisory approval of internal models

17.13 Where a supervisor allows the use of internal models to determine regulatory capital requirements, the supervisor requires:

- **prior supervisory approval for the insurer's use of an internal model for the purpose of calculating regulatory capital requirements;**
- **the insurer to adopt risk modelling techniques and approaches appropriate to the nature, scale and complexity of its current risks and those incorporated within its risk strategy and business objectives in constructing its internal model for regulatory capital purposes;**
- **the insurer to validate an internal model to be used for regulatory capital purposes by subjecting it, as a minimum, to three tests: "statistical quality test", "calibration test" and "use test"; and**
- **the insurer to demonstrate that the model is appropriate for regulatory capital purposes and to demonstrate the results of each of the three tests.**

Approval of the use of an internal model for determination of regulatory capital requirements

17.13.1 Where insurers may be permitted to use internal models for calculating regulatory capital requirements, the models used for that purpose should be subject to prior supervisory approval. The onus should be placed on the insurer to validate a model that is to be used for regulatory capital

purposes and provide evidence that the model is appropriate for those purposes. The IAIS considers that an insurer should not need supervisory approval for the use of internal models in determining its own economic capital needs.

17.13.2 The supervisor may prescribe requirements which will allow it to assess different models fairly and facilitate comparison between insurers within its jurisdiction. However, overly prescriptive rules on internal model construction may be counter-productive in creating models which are risk-sensitive and useful for insurers. Therefore, although a certain level of comparability can be achieved by the calibration requirements, full and effective comparison across jurisdictions to align best practice may be best achieved by dialogue between supervisors and industry.

17.13.3 The supervisor should require that in granting approval for the use of an internal model to calculate regulatory capital requirements, it has sufficient confidence that the results being produced by the model provide adequate and appropriate measures of risk and capital. Although the supervisor may encourage insurers to develop internal models that better reflect their risks as soon as possible, this should not lead to models being approved until there is confidence that they are calibrated correctly. The supervisor may therefore feel it necessary to evaluate an internal model over a specified period of time, for example a few years, prior to approval. For supervisors, approval of an internal model could require considerable expertise (depending on the sophistication of the model) which may need to be developed. In addition, it may be necessary to introduce different supervisory powers to allow the approval of internal models.

17.13.4 The supervisor should use, at a minimum, the “statistical quality test”, “calibration test” and “use test”, as the basis of its approval process. While a broad range of internal model approaches may be suitable for internal economic capital assessment purposes, and this should not be subject to supervisory approval, supervisors may want to place requirements on the internal model approaches that would be regarded as acceptable for regulatory capital purposes. In approving the use of an internal model for calculating regulatory capital requirements, the supervisor should consider the primary role of the model as part of the insurer's risk management procedures. Any requirements imposed by the supervisor on the approval of a model for use in determining regulatory capital requirements should not prevent the model from being sufficiently flexible to be a useful strategic decision making tool which reflects the insurer's unique risk profile. Consistent standards for the approval of an insurer’s internal model should be applied by the supervisor, regardless of whether the model is developed in-house by the insurer or by an external party.

17.13.5 The “statistical quality test” and the “use test” are envisaged to be more insurer-specific measures which should allow the supervisor to gain an understanding of how a particular insurer has embedded its internal model within its business. The “calibration test” would be used by the supervisor to assess the results from the internal model in comparison to the insurer’s regulatory capital requirements and to those of other insurers.

17.13.6 In addition, the insurer should review its own internal model and validate it so as to satisfy itself of the appropriateness of the model for use as part

of its risk and capital management processes.[73] As well as internal review, the insurer may wish to consider a regular independent, external review of its internal model by appropriate specialists.

Additional guidance for group-wide internal models

17.13.7 Each supervisor who permits the use of internal models for regulatory capital purposes at legal entity and/or group level should require prior supervisory approval for that purpose.

If an insurance group wishes to use its group-wide internal model for regulatory capital purposes in more than one jurisdiction in which it operates, the group may be subject to requirements that differ in a number of ways. Examples of some areas of possible variation may include:

- modelling criteria (risk measure, time horizon, level of safety);
- valuation bases for regulatory capital purposes;
- the risks that have to be modelled;
- treatment of intra-group transactions;
- approach to group-wide capital adequacy (e.g. group level or legal entity focus); and
- recognition of diversification across the group.

A group-wide internal model therefore needs to be sufficiently flexible to meet the differing requirements of each jurisdiction in which it is to be used for regulatory capital purposes.

17.13.8 The supervisors of an insurance group that conducts insurance business in more than one jurisdiction may consider their joint and common interests for the joint approval of the use of a group-wide internal model for regulatory capital purposes. If so, it may improve the efficiency and effectiveness of the approval process if the supervisors agree on common requirements for the process e.g. standardised language or languages for the application process.

17.13.9 Alternatively, the supervisors may independently approve the use of a group-wide internal model. Therefore, an insurance group seeking approval for a group-wide internal model may receive permission from one supervisor to use the model in that jurisdiction, while not receiving approval in another jurisdiction.

17.13.10 Similarly, where an insurance legal entity operates in other jurisdictions through a branch structure, the supervisors in those branch jurisdictions will have an interest in the solvency of the insurance legal entity. If local branch supervisors in these jurisdictions are not satisfied with the capital requirements of the home supervisor, possibly because they are determined using internal models, the local branch supervisors may impose limitations on the branch operations. The home supervisor, however, does not need to have the approval of the local branch

[73] Validation should be carried out by a different department or personnel to those that created the internal model to facilitate independence.

supervisors in order to approve the use of the insurance legal entity's internal model for its own purposes.

17.13.11 The degree of involvement of different supervisors in the approval process depends on a number of factors as illustrated in Guidance 17.13.12 - 17.13.16.

17.13.12 In the simplest case, an insurance group operates in one jurisdiction only. Clearly only the supervisor in that jurisdiction needs to be involved in the group-wide internal model approval process. Where there is more than one supervisor in a jurisdiction, e.g. where different insurance activities of a group are supervised separately, then both may need to be involved depending on the scope of the model. Nevertheless, some liaison with supervisors in other jurisdictions may be mutually beneficial to facilitate convergence and comparability across jurisdictions in respect of internal model standards and practice.

17.13.13 In the case of an insurance group that operates in more than one jurisdiction but only applies to use its group-wide internal model for regulatory capital purposes in one jurisdiction, e.g. the parent's jurisdiction, the group does not need group-wide internal model approval of other jurisdictions provided that it is using other approaches to meet the capital requirements of those other jurisdictions. However, the supervisor considering approval of the group-wide internal model may wish to consult the other supervisors about the relevant insurance markets, the group's operations in those markets and the standard of modelling.

17.13.14 In the case of an insurance group that wishes to use its group-wide internal model in more than one jurisdiction (e.g. to calculate insurance legal entity PCRs), the supervisor of each of those jurisdictions should consider approval of the specific application of the group-wide internal model in its jurisdiction, having regard to the considerations in Guidance 17.13.15 - 17.13.18 below.

17.13.15 When considering approval of the use of a group-wide internal model for group-wide regulatory capital purposes, each supervisor should consider:

- its group-wide regulatory capital requirements;
- whether and the extent to which its jurisdiction allows the use of internal models for regulatory capital purposes (e.g. PCR or both PCR and MCR);
- how its jurisdiction interacts with the other jurisdictions potentially involved when supervisory intervention is being considered; and
- the arrangements for collaboration between the supervisors of the entities within the insurance group.

17.13.16 A supervisor may delegate the approval process to another supervisor or agree to be bound by its decision while retaining supervisory responsibility. Alternatively, a group-wide supervisor may have ultimate decision-making authority over some or all of the supervisors involved. If more than one jurisdiction is concerned, making such authority legally binding may require a treaty between these jurisdictions. To be effective,

each arrangement requires a high level of collaboration between supervisors. To require the model appropriately addresses all categories of risk, the supervisor making the decision needs sufficient knowledge of the local circumstances in which the group operates.

17.13.17 Supervisors should require that the approval process for the use of a group-wide internal model for regulatory capital purposes is sufficiently flexible to achieve an approach appropriate to **the nature, scale and complexity** at each organisational level in an insurance group (group/sub-group/individual insurance legal entity). Risks which may have a large impact at insurance legal entity level may have much smaller significance at insurance group level. Conversely, risks that may have a small impact at insurance legal entity level may aggregate to have a larger impact on risk at the group level. The nature and complexity of risks may also vary at different levels in the insurance group.

17.13.18 Whether the group-wide internal model is appropriate for regulatory purposes given the nature, scale and complexity of the risks depends on the regulatory capital requirements of a jurisdiction. While the risk coverage by an internal model may look reasonable from a group-wide perspective, it may not be reasonable from the point of view of each member of the insurance group. For example, in a group of many non-life insurers and one small life insurer it may be appropriate from an overall perspective to place less emphasis on the modelling of the life insurance risks. However this may not be appropriate from the life insurer's or supervisor's perspective. In such circumstances, it may be necessary for the group to upgrade its model to include an adequate life insurance risk component or to set up a self-contained internal model for the life insurer in order to gain approval.

Statistical quality test for internal models

17.14 Where a supervisor allows the use of internal models to determine regulatory capital requirements, the supervisor requires:

- **the insurer to conduct a "statistical quality test" which assesses the base quantitative methodology of the internal model, to demonstrate the appropriateness of this methodology, including the choice of model inputs and parameters, and to justify the assumptions underlying the model; and**
- **that the determination of the regulatory capital requirement using an internal model addresses the overall risk position of the insurer and that the underlying data used in the model is accurate and complete.**

17.14.1 Given the importance of an embedded internal model to an insurer's risk management policy and operations, an internal model would generally be constructed to deliver a probability distribution of the required risk capital rather than a "point estimate". A range of approaches could constitute an effective internal model for risk and capital management purposes, and supervisors should encourage the use of a range of different approaches appropriate to the nature, scale and complexity of different insurers and different risk exposures. There are several different techniques to quantify risk which could be used by an insurer to construct its internal model. In broad terms, these could range from basic deterministic scenarios to

complex stochastic models. Deterministic scenarios would typically involve the use of stress and scenario testing reflecting an event, or a change in conditions, with a set probability to model the effect of certain events (such as a drop in equity prices) on the insurer's capital position, in which the underlying assumptions would be fixed. In contrast, stochastic modelling often involves simulating very large numbers of scenarios in order to reflect the likely distributions of the capital required by, and the different risk exposures of, the insurer.

17.14.2 The IAIS recognises that there are numerous methodologies which an insurer could use as part of its stress and scenario testing. For example, an insurer may decide to model the effect of various economic scenarios, such as a fall in equity prices or a change in interest rates, on its assets and liabilities. Alternatively, an insurer could consider a run-off approach, where the effect of various scenarios on a specific portfolio of business as it is run-off is examined. The insurer should use scenarios which it regards as most appropriate for its business. Where the internal model is used for regulatory capital purposes, the onus is on the insurer to demonstrate to the supervisor that the chosen methodology is appropriate to capture the relevant risks for its business. This includes testing of the model to require that it can replicate its results on request and that its response to variation in input data is adequate such as that corresponding to changes in base or stress scenarios. Overall capital requirements derived from an internal model can be highly sensitive to assumptions on the effect of diversification across risks. Supervisors and insurers should therefore give particular consideration to aggregation issues. Conducting stress and scenario testing to determine the effect of shocks may be a suitable tool to validate statistical assumptions.

17.14.3 ***W***here an internal model is established to assess risks at a modular level, i.e. on a risk-by-risk basis, in order to conduct an overall risk assessment, the insurer should aggregate the results for each of these risks both within and across business lines. Several methods exist to aggregate the separate results allowing for diversification effects. The IAIS considers that an insurer would generally be expected to decide how best to aggregate and account for the risks to the whole of its business. The determination of overall regulatory capital requirements by the internal model should consider dependencies within, as well as across, risk categories. Where the internal model allows for diversification effects, the insurer should be able to justify its allowance for diversification effects and demonstrate that it has considered how dependencies may increase under stressed circumstances.

17.14.4 Internal models need high quality data in order to produce sufficiently reliable results. The data used for an internal model should be current and sufficiently credible, accurate, complete and appropriate.Hence, a "statistical quality test" should examine the appropriateness of the underlying data used in the construction of the internal model. A "statistical quality test" would include the examination of the aggregation of data, the modelling assumptions and the statistical measures used to construct the internal model. This could include an annual (or more frequent) review of the various items that are being measured (claims, lapses, etc.) updated for the additional data available together with a scrutiny of data from previous periods to determine whether this data

continues to be relevant. Older data may no longer be relevant possibly due to changes in risks covered, secular trends or policy conditions and guarantees attaching. Similarly, new data may not be of substantive use when modelling items that require a long-term view of experience (such as testing the predictions of cash flows for catastrophic events).

17.14.5 An insurer may not always have sufficient reliable data in-house. In instances where an insurer lacks fully credible data it may rely on industry or other sufficiently credible data sources to supplement its own data. For example, a new company may lack its own historical data and so could use market data sources in constructing its internal model. Some supervisors have published jurisdictional data which may be of some use.

17.14.6 Another possible source of data may be from reinsurers - whose data pool is typically larger and covers a wider spectrum of the market. It is, however, important to consider that such industry data may not be entirely appropriate for all insurers. Reinsurers often only receive data in aggregated form and sometimes are only informed of larger claims or from smaller insurers whose market may not be applicable for all or many insurers. Therefore, any data not specific to the insurer would need to be carefully considered before deciding it was appropriate for use as the basis for an insurer's “statistical quality test”. Even where deemed appropriate, it may still be necessary to adjust the data to allow for differences in features between the data source and the insurer.

17.14.7 In assessing suitability of data and of other inputs, e.g. assumptions, to the internal model, expert judgment should be applied and supported by proper justification, documentation and validation.

17.14.8 As part of the “statistical quality test”, the insurer should be able to demonstrate that the base quantitative methodology used to construct its internal model is sound and sufficiently reliable to support the model's use, both as a strategic and capital management tool, and to calculate the insurer's regulatory capital requirements, if appropriate. The methodology should also be consistent with the methods used to calculate technical provisions.

17.14.9 A “statistical quality test” should also include a review of the internal model to determine whether the assets and products as represented in the model truly reflect the insurer's actual assets and products. This should include an analysis of whether all reasonably foreseeable and relevant material risks have been incorporated, including any financial guarantees and embedded options. Insurers should also consider whether the algorithms used are able to take into account the action of management and the reasonable expectation of policyholders. Testing should include future projections within the model and to the extent practicable “back-testing” (the process of comparing the predictions from the model with actual experience).

Additional guidance for group-wide internal models

17.14.10 For use in determining the regulatory capital requirements of an insurance legal entity, a group-wide internal model should meet the same standards as applicable to a stand-alone internal model of that insurer.

17.14.11 For use for group-wide regulatory capital requirements, group members should be sufficiently engaged with a group-wide internal model and its application to their businesses (through their input to the model, local Board involvement, capital allocation, performance measurement etc.), even if the insurance group does not use the model to determine the regulatory capital requirements of individual group members.

Calibration test for internal models

17.15 Where a supervisor allows the use of internal models to determine regulatory capital requirements, the supervisor requires the insurer to conduct a "calibration test" to demonstrate that the regulatory capital requirement determined by the internal model satisfies the specified modelling criteria.

17.15.1 As part of a "calibration test", where an internal model is used for determining regulatory capital, the insurer should assess the extent to which the output produced by its internal model is consistent with the modelling criteria defined for regulatory capital purposes, and hence, confirm the validity of using its internal model for that purpose.

17.15.2 The "calibration test" should be used by the insurer to demonstrate that the internal model is calibrated appropriately to allow a fair, unbiased estimate of the capital required for the particular level of confidence specified by the supervisor. Where an insurer uses different modelling criteria than those specified by the supervisor for regulatory capital purposes, it may need to recalibrate its model to the supervisor's modelling criteria to achieve this.

Additional guidance for group-wide internal models

17.15.3 See Guidance 17.14.10 and 17.14.11 for additional guidance for group-wide internal models.

Use test and governance for internal models

17.16 Where a supervisor allows the use of internal models to determine regulatory capital requirements, the supervisor requires:

- **the insurer to fully embed the internal model, its methodologies and results, into the insurer's risk strategy and operational processes (the "use test");**
- **the insurer's Board and Senior Management to have overall control of and responsibility for the construction and use of the internal model for risk management purposes, and ensure sufficient understanding of the model's construction at appropriate levels within the insurer's organisational structure. In particular, the supervisor requires the insurer's Board and Senior Management to understand the consequences of the internal model's outputs and limitations for risk and capital management decisions; and**
- **the insurer to have adequate governance and internal controls in place with respect to the internal model.**

17.16.1 In considering the use of an internal model for regulatory capital purposes by an insurer, the supervisor should not merely focus on its use for that narrow purpose, but should consider the wider use of the internal model by the insurer for its own risk and capital management.

17.16.2 The “use test” is the process by which the internal model is assessed in terms of its application within the insurer's risk management and governance processes. In order for the insurer’s internal model to be most effective it should be genuinely relevant for use within its business for risk and capital management purposes.

17.16.3 Where an insurer decides to adopt a higher confidence level than the level required for regulatory capital purposes for its own purposes, for example, in order to maintain a certain investment grade rating, then “calibration” testing should also be conducted by the insurer to allow the insurer to determine the level of capital needed at this higher level. The insurer should then assess whether holding this amount of capital is consistent with the insurer's overall business strategy.

17.16.4 The insurer should have the flexibility to develop its internal model as an important tool in strategic decision making. An insurer should therefore have the flexibility to use the most appropriate risk measure and modelling techniques in its internal models. It may be beneficial if the insurer is able to demonstrate why it has chosen a particular risk measure, and it should include in its internal model an appropriate recalibration or reconciliation, if necessary, between the modelling criteria used in the model for its own risk and capital management purposes and those set by the supervisor for regulatory capital purposes. Differences between the economic capital and the regulatory capital requirements should be explicit and capable of being explained by the insurer to its Board and the supervisor.

17.16.5 The “use test” is a key method by which the insurer can demonstrate that its internal model is integrated within its risk and capital management and system of governance processes and procedures. As part of the “use test”, an insurer should examine how the internal model is used for operational management purposes, how the results are used to influence the risk management strategy and business plan of the insurer, and how senior management are involved in applying the internal model in running the business. An insurer should demonstrate to the supervisor that an internal model used for regulatory capital purposes remains useful and is applied consistently over time and that it has the full support of and ownership by the Board and Senior Management.

17.16.6 The insurer's Senior Management should take responsibility for the design and implementation of the internal model, in order to ensure full embedding of the model within the insurers' risk and capital management processes and operational procedures. The methodology used in building the model should be compatible with the overall enterprise risk management framework agreed to by the Board and Senior Management. Although the Board and Senior Management may not be able to de-construct the internal model in detail, it is important that the Board has overall oversight of the model's operation on an ongoing basis and the level of understanding necessary to achieve this. The Board and Senior Management should also ensure that processes are in place to

update the internal model to take into account changes in the insurer's risk strategy or other business changes.

17.16.7 Various business units within the insurer may be involved in the construction and operation of the internal model, such as risk management, capital management, finance and actuarial departments, depending on the size of the insurer. The experience and technical ability of staff involved in the construction and operation of the internal model should be an important consideration for the insurer. For a model to pass the "use test" it would be expected that an insurer would have a framework for the model's application across business units. This framework should define lines of responsibility for the production and use of information derived from the model. It should also define the purpose and type of management information available from the model, the decisions to be taken using that information, and the responsibilities for taking those decisions. The "use test" should also ensure the adequacy of systems and controls in place for the maintenance, data feeds and results of the model. The IAIS notes that internal models may require significant IT resources and costs, which should be a consideration for the insurer in developing its models.

17.16.8 The IAIS considers that governance processes and communication in respect of an internal model are as important as its construction. An internal model should be subject to appropriate review and challenge so that it is relevant and reliable when used by the insurer. The key elements and results from the internal model should be understood by the key personnel within the insurer, including the Board, and not only by those who have constructed it. This understanding should ensure that the internal model remains a useful decision-making tool. If the internal model is not widely understood, it will not be achieving its purpose and adding value to the business. The "use test" is key in ensuring the relevance of the internal model to the insurer's business.

Additional guidance for group-wide internal models

17.16.9 See Guidance 17.14.10 and 17.14.11 for additional guidance for group-wide internal models.

Documentation for internal models

17.17 Where a supervisor allows the use of internal models to determine regulatory capital requirements, the supervisor requires the insurer to document the design, construction and governance of the internal model, including an outline of the rationale and assumptions underlying its methodology. The supervisor requires the documentation to be sufficient to demonstrate compliance with the regulatory validation requirements for internal models, including the statistical quality test, calibration test and use test outlined above.

17.17.1 The insurer should document the design and construction of the internal model sufficient for a knowledgeable professional in the field to be able to understand its design and construction. This documentation should include justifications for and details of the underlying methodology, assumptions and quantitative and financial bases, as well as information on the modelling criteria used to assess the level of capital needed.

17.17.2 The insurer should also document, on an ongoing basis, the development of the model and any major changes, as well as instances where the model is shown to not perform effectively. Where there is reliance on an external vendor/supplier, the reliance should be documented along with an explanation of the appropriateness of the use of the external vendor/supplier.

17.17.3 The insurer should document the results of the "statistical quality test", "calibration test" and "use test" conducted to enable the supervisor to assess the appropriateness of its internal model for regulatory capital purposes.

Additional guidance for group-wide internal models

17.17.4 In view of the potential complexity of a group-wide internal model, the flexibility required and the potential need for multiple supervisory approvals, it is essential that the group fully document all aspects of the group-wide internal model clearly and unambiguously. This enables supervisors to identify what is approved and what is not approved. Supervisors should require the insurance group to provide thorough documentation of the scope of an internal model, clarifying what falls within and outside of the model boundaries and what parts of the group universe are modelled. Supervisory authorities should know the boundary to the internal model.

17.17.5 As a minimum, the documentation of the group-wide internal model should include:

- a full description of the risk profile of the insurance group and how the group models those risks, including the underlying central assumptions and methods;
- the parts, entities and geographical locations of the insurance group and which are included or excluded from the scope of the model submitted for approval;
- specification of which risks are modelled, with particular focus on group-wide risks;
- intra-group transactions such as (subordinated) loans and other hybrid instruments together with their different level of triggers, guarantees, reinsurance, capital and risk transfer instruments, contingent assets and liabilities; off-balance sheet items and special purpose vehicles;
- the effect of these instruments, either on individual insurance legal entities or on the insurance group considered as one single economic entity or on both, depending on supervisory requirements and how these effects are modelled;
- justifications for specific decisions taken in terms of assumptions, scope, simplifications;
- the flexibility of the model architecture to cope with central assumptions ceasing to be valid;

- more generally the insurance group's processes for validating, maintaining and updating the model including the use of stress testing and scenario analysis and the results of those tests and analyses;
- how the model allows for and models fungibility of capital, transferability of assets and liquidity issues, the assumptions made especially regarding the treatment of intra-group transactions and the free flow of assets and of liabilities across different jurisdictions, and how the group uses the model for an analysis or a qualitative assessment of liquidity issues; and
- the allocation of capital to insurance legal entities implied by the group-wide model and how this would change in times of stress for insurance groups established in more than one jurisdiction. Such allocation is required by supervisors, even if an insurance group uses a different allocation, e.g. by region or business line, for management purposes.

17.17.6 If elements are omitted from the group-wide internal model, the supervisors should require an explanation within the required documentation, for example if and why a standardised approach is used for some insurance legal entities, lines of business or risks.

17.17.7 The supervisors should require the insurance group to provide documentation describing whether and how the modelling is consistent over different jurisdictions or insurance legal entities regarding, for example, modelling criteria, risks, lines of business, intra-group transactions or capital and risk transfer instruments (CRTIs) with suitable explanations for any differences in approach.

17.17.8 Diversification/concentration of risks means that some risks or positions are offset or increased by other risks or positions. The supervisors should require, within the framework of the required internal model documentation, a description of how the insurance group:

- incorporates diversification/concentration effects at the relevant different levels within the group-wide internal model;
- measures such effects in normal and in adverse conditions;
- confirms those measurements for reasonableness, and
- allocates diversification effects across the group according to supervisory requirements.

Credit for diversification effects should only be allowed where appropriate having regard to risk correlations in adverse financial conditions.

Ongoing validation and supervisory approval of the internal model

17.18 Where a supervisor allows the use of internal models to determine regulatory capital requirements, the supervisor requires:

- **the insurer to monitor the performance of its internal model and regularly review and validate the ongoing appropriateness of the model's specifications. The supervisor requires the insurer to demonstrate that the model remains fit for regulatory capital purposes in changing**

circumstances against the criteria of the statistical quality test, calibration test and use test;

- **the insurer to notify the supervisor of material changes to the internal model made by it for review and continued approval of the use of the model for regulatory capital purposes;**
- **the insurer to properly document internal model changes; and**
- **the insurer to report information necessary for supervisory review and ongoing approval of the internal model on a regular basis, as determined appropriate by the supervisor. The information includes details of how the model is embedded within the insurer's governance and operational processes and risk management strategy, as well as information on the risks assessed by the model and the capital assessment derived from its operation.**

17.18.1 Over time an insurer's business may alter considerably, as a result of internal factors or events (such as a change in insurer strategy) and external factors or events (such as a change in interest rates), so that the internal model may no longer fully capture the risks to which the insurer is exposed unless adapted. The supervisor should reassess an insurer's internal model and the results that it produces on a regular basis against the criteria of the statistical quality test, calibration test and use test so that it remains valid for use, both as a strategic decision-making tool in the context of the insurer's own risk and capital management, and as a means of calculating regulatory capital requirements where appropriate. In general only material changes to the model (such as changing the underlying model structure or the risk measure used) or to the risks faced by the insurer should require the model to be reassessed by the supervisor. A "model change policy" could be agreed between the supervisor and the insurer regarding the degree and timing of changes made to the internal model. This would enable the insurer to enact minor changes to its internal model without seeking prior supervisory approval (provided the changes are in accordance with the agreed policy), thereby allowing the model to be updated in a quicker and more flexible way.

17.18.2 The insurer should be required to notify the supervisor of material changes to the internal model and to properly document changes to enable the supervisor to assess, for continued approval, the ongoing validity of the model for use in determining regulatory capital requirements. Following any material changes to an internal model, the supervisor may give the insurer a reasonable amount of time so that the updated model is embedded in its risk strategies and operational processes.

17.18.3 The insurer should demonstrate that the data used in the internal model remains appropriate, complete and accurate for this purpose.

17.18.4 The supervisor should take care that its ongoing validation requirements do not unduly restrict the use of the internal model by the insurer for its own risk and capital management purposes and thereby reduce its ability to comply with the use test.

Additional guidance for group-wide internal models

17.18.5 The insurance group should adjust the model for material changes in group composition and operations, including mergers, acquisitions and other structural changes of affiliated entities or jurisdictional changes.

17.18.6 The supervisor should require the insurance group to provide documentation of material changes in group operations and the reasons why continued use of the group-wide internal model would remain appropriate following the change. If such reasons cannot be given or are not sufficient the supervisor should require the group to propose appropriate model changes as a result of the material change for re-assessment of approval by the supervisor.

Supervisory responsibilities

17.18.7 The IAIS considers that it is essential that supervisors are able to understand fully the insurers' internal models and be able to appraise their quality. To this end, the supervisor should have access to experienced personnel with appropriate technical ability, as well as sufficient resources. It is likely to take time for supervisors to acquire the necessary experience to appraise an insurer's internal model. Without the experience and resources, the supervisor may be unable to reliably approve the use of an insurer's internal model for regulatory purposes. The supervisor may wish to use external specialists that are considered to have the appropriate experience, such as actuarial consultants, accountancy firms and ratings agencies, to assist it in reviewing an insurer's internal models. In such instances, the supervisor should retain the final responsibility for review and approval of the use of the internal model for regulatory purposes.

17.18.8 It may be appropriate for a supervisor to consider transitional measures when permitting insurers to use internal models for regulatory capital purposes for their first time. Such measures will permit the necessary time for both insurers and the supervisor to become familiar with the internal models and their uses. For example, during a transition period, the supervisor could include the use of partial internal modelling, to allow the insurer to move gradually to full use of internal models or the supervisor could require parallel reporting of regulatory capital determined by both the internal model and standardised approach. The supervisor may also consider applying a minimum capital level during the transition period.

17.18.9 The supervisor may need to impose additional capital requirements (capital add-ons) or take other supervisory action to address any identified weaknesses in an internal model, either prior to approving the use of the model, as a condition on the use of the model or in the context of a review of the ongoing validity of an internal model for regulatory capital purposes. It may be necessary to introduce additional supervisory powers, to allow such supervisory actions and measures, when internal models are allowed for regulatory capital purposes by a supervisor.

17.18.10 Where an insurer which is a subsidiary of an insurance group seeks approval for the use of an internal model which itself is part of a broader "group model", the supervisor of this subsidiary should conduct the approval process in close co-operation with the group-wide supervisor. In particular, the supervisor of the subsidiary should check the status of the

"group model" and seek information from the group-wide supervisor about its own approval process.

Supervisory reporting

17.18.11 For supervisory approval purposes, supervisors should require the insurer to submit sufficient information for them to be able to approve the use of the internal model for regulatory capital purposes and to give confidence to the supervisor that the insurer is appropriately carrying out its responsibility to manage its risks and protect the interests of policyholders. This should include the results of analysis conducted under the "statistical quality test", "calibration test" and "use test". While supervisors should have the power to determine the exact nature and scope of the information they require, supervisory reporting should be ***appropriate to*** the nature, scale and complexity of an insurer's business.

17.18.12 The level of information on internal models necessary to allow meaningful assessment by supervisors would be expected to include appropriate information regarding the insurer's risk and capital management strategy – for example, how the model is embedded into the insurer's governance procedures, overall business strategy, operational procedures and risk processes. An insurer should report details of the risks assessed by the model, including how these are identified and measured, as well as information on the results of the internal model analysis, the economic capital derived from these results and how the results of the internal model compare to those derived from the supervisory standardised approach.[74]

[74] Supervisors may consider that the comparison between the capital requirements from an internal model and a supervisory standardised approach should only be required during a transition period.

ICP 18 Intermediaries[75]

The supervisor sets and enforces requirements for the conduct of insurance intermediaries, in order that they conduct business in a professional and transparent manner.

Introductory Guidance

18.0.1 There is a diverse range of organisations and individuals carrying out insurance intermediation, and channels through which this is undertaken. In order to ensure consumer protection and to promote a level playing field amongst these actors, this ICP applies to the supervision of those conducting the activity of insurance intermediation. Some of the Standards under this ICP apply to the supervision of the individuals providing insurance intermediation services to customers. Other Standards apply to the organisation within which the insurance intermediation is carried out; where this is the case, it is made clear in the corresponding guidance. Where an insurer's direct sales staff solicit, negotiate or sell insurance as employees of the insurer, the supervisor would apply the relevant Standards to the insurer.

18.0.2 Some intermediaries do not have direct contact with the customer but act with other intermediaries to place business with insurers (such as wholesale intermediaries). Even though they do not necessarily deal directly with the purchaser of insurance, they perform one of the functions in the chain of soliciting, negotiating or selling insurance, and are within the scope of this ICP.

18.0.3 Where the Standards under this ICP apply to the intermediary as an organisation, the supervisor should hold those responsible for the intermediary's governance to account for implementation of the requirements.

18.0.4 Individuals or organisations which only refer (or introduce) potential customers to an insurer or insurance intermediary, without carrying out insurance intermediation, are excluded from the scope of this ICP. Also excluded from the scope are persons, such as tax advisers or accountants, who in conducting another professional activity provide:

- advice on insurance cover on an occasional basis in the course of that other activity; or
- information of a general nature on insurance products (without advising on the choice of insurance product provider),

provided that the purpose of that professional activity is not to intermediate an insurance contract.

18.0.5 Insurance intermediaries may also perform functions supplemental to insurance intermediation, many of which may be described as outsourced functions of the insurer. These supplemental functions may include underwriting, premium collection, administration, management of

[75] Amended November 2017

insurance claims, loss adjusting and claims appraisal. These functions are excluded from the IAIS definition of insurance intermediation. However, in some jurisdictions these supplemental functions are included in their definition of insurance intermediation. The outsourcing of processes that are relevant to business conduct is addressed in other ICPs (see ICP 19 Conduct of Business and – for insurers – ICP 8 Risk Management and Internal Controls).

18.0.6 Insurance intermediation involves the interface between insurers and customers. Effective assessment of the quality of insurance intermediation to a large extent requires supervisory consideration of policies, processes and procedures that relate to individual customer relationships and individual transactions.

18.0.7 Where intermediaries are part of a group, the application of appropriate policies and procedures on insurance intermediation should be consistent across the group, recognising local requirements and specificities, and should result in the fair treatment of customers on a group-wide basis.

Proportionality with regard to intermediaries

18.0.8 Intermediation systems and practices are closely linked with jurisdictions' tradition, culture, legal regime and the degree of development of insurance markets. For this reason, supervisory approaches to insurance intermediation also tend to vary. Such diversity should be taken into consideration in implementing this ICP in order to promote the fair treatment of customers.

18.0.9 In implementing this ICP, the supervisor should take into account that there are various business models ranging from sole traders to large enterprises, including specialist wholesale or reinsurance intermediaries.

18.0.10 The nature of the customers with which an intermediary interacts and the complexity of the products offered are also relevant to the supervisory approach. Retail customers, in particular vulnerable consumers, have different needs in terms of consumer protection than professional ones; life products with an investment element are typically more complex than general personal lines products.

18.0.11 In light of market diversity, in implementing this ICP, the supervisor should consider focusing on the activity carried out by the intermediary, to ensure consistency and minimise the opportunity for regulatory arbitrage.

18.0.12 Supervisors are faced with balancing the need for consumers to receive an appropriate level of protection and the benefits of innovation and competition. The supervisor should consider whether its licensing and supervisory requirements impose unreasonable barriers to entry for small or emerging intermediary businesses, or inhibit beneficial innovations, and thereby limit the accessibility of insurance coverage to consumers.

Types of intermediaries

18.0.13 Intermediaries fall into two categories: i) acting primarily on behalf of the insurer; or ii) acting primarily on behalf of the customer:

- Where the intermediary acts primarily on behalf of the insurer and sells products for, and on behalf of, one or more insurers, they are often referred to as "agent" or "producer". Intermediaries may act for a single insurer (sometimes referred to as "tied") or several. The products they can offer may be restricted by agency agreements with the insurer(s) concerned.
- Where the intermediary acts primarily on behalf of the customer, the intermediary is independent of the insurer(s) whose products he sells. Often referred to as "broker", or "independent financial adviser", they are able to select products from those available across the market.

18.0.14 Some supervisors do not distinguish between different intermediary categories in legislation and instead supervise according to the activity performed. In some jurisdictions, it may be possible for an intermediary to have a different status depending on the customer relationship and the product or service being offered. In others, an intermediary is prevented from acting in any capacity other than the one in which it has been licensed to do business, in order to avoid conflicts of interest.

18.0.15 Intermediary operations range from large international organisations to local sole traders. Intermediary organisations sometimes operate as independent enterprises or divisions of insurers or other financial institutions, or as part of non-financial organisations. Insurance intermediation may also be performed by digital means, such as website and mobile phone applications.

18.0.16 Insurers use various distribution channels to market and sell insurance products. These can include a variety of partners - such as car dealerships, post offices, mobile phone operators, travel agents, other financial institutions and other retailers - who offer insurance alongside or as an add-on to the primary goods and services in which they trade. In many cases the activities of these distribution channels would constitute intermediation.

Intermediaries' role in promoting public trust and confidence in the insurance sector

18.0.17 In most insurance markets, intermediaries serve as important distribution channels of insurance. Their good conduct and professional competence are essential to promote confidence in insurance markets.

18.0.18 It is in the interests of supervisors, in promoting fair, safe and stable insurance markets, that the public has trust and confidence in the insurance sector. Insurance intermediaries' interface between consumers and insurers gives them a key role in building and justifying this public trust and confidence.

18.0.19 In some jurisdictions, intermediaries' duty to act in a professional and transparent manner is supported by professional bodies and other interested organisations. Such organisations encourage, amongst other things, the obtaining of professional qualifications, continuous professional development, ethical behaviour, the fair treatment of customers and better communication with the public. Such measures are

aimed at enhancing public confidence in insurance intermediaries through raising professional standards.

Intermediaries' role in promoting financial awareness

18.0.20 Intermediaries can promote consumer protection by assisting consumers to make better informed decisions about the products that they buy. This helps to address a core consumer protection concern about asymmetries of information between financial services product providers and the public to whom the products are sold. The adoption of good conduct of business practices by insurers and insurance intermediaries helps to ensure that customers are sufficiently informed on the insurance products they are considering buying, before concluding a contract.

18.0.21 Enhancing financial awareness is a further means of ensuring that consumers are aware of the types of products available to them and understand their purpose, how they work and their key features, including cost. This understanding helps consumers to compare products and to purchase insurance products that meet their needs. Enhanced financial awareness can be achieved, for example, through formal education initiatives and targeted awareness campaigns led by insurers and intermediaries, individually or jointly.

18.0.22 The promotion of financial awareness may benefit consumers in jurisdictions where consumer protection standards are weak or levels of financial literacy are low. It is also especially important when dealing with more complex financial products, particularly those with an investment element.

18.0.23 Improved understanding by consumers of the terms and benefits they can expect from insurance products may also lead to a reduction in complaints against intermediaries or the insurers whose products they sell.

18.0.24 Insurance intermediaries are not the only stakeholders in promoting the financial awareness of consumers; governments, supervisors, social interest organisations and insurers have a significant role to play in consumer protection. Other stakeholders, using various communication channels, are also able to play a significant role. Nevertheless, intermediaries' face-to-face dealings with their customers and marketing of products to consumers place them in a position to contribute to strengthening the financial awareness of the public on insurance matters. Supervisors may therefore wish to encourage insurance intermediaries to promote financial awareness.

18.0.25 A variety of means may be used by insurance intermediaries to promote financial awareness, such as:

- explaining face-to-face the features of products in which customers may be interested, which may be particularly important where their interest is in complex or long term contracts;
- providing references to specific websites or other reference material which gives relevant information, or publishing such material themselves;

- making available, or suggesting other sources of, financial tools such as on-line calculators which estimate premiums or coverage levels; or
- participating in educational initiatives such as training seminars.

18.0.26 In undertaking financial education initiatives, intermediaries should ensure that the personnel involved have sufficient knowledge for this purpose and that material or tools provided are up to date, free from error to the extent practicable, and easily understood. Such initiatives may target specific audiences, such as vulnerable groups.

18.0.27 Intermediaries' initiatives to promote financial awareness, where conducted with professionalism, may help to enhance both their own reputation and that of the insurance sector.

Additional ICPs applicable to the supervision of intermediaries

18.0.28 ICP 19 (Conduct of Business) addresses conduct of business supervision in respect of both intermediaries and insurers, whereas this ICP addresses other aspects of supervision that are specific to intermediaries. Other ICPs that apply, generally or in part, to the supervision of intermediaries are:

- ICP 21 Countering Fraud in Insurance; and
- ICP 22 Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT).

Supervisory cooperation

18.0.29 In some jurisdictions, the supervision of insurance intermediaries is the responsibility of a different authority than the insurance conduct of business supervisory authority. Even where the same authority is responsible for conduct of business and intermediary supervision, the supervisory responsibilities are often undertaken within different departments. Where different authorities or departments are involved, the insurance intermediary supervisor should communicate, and cooperate where possible, with other relevant authorities and departments to ensure an understanding of all the risks relevant to their supervision of insurance intermediaries.

18.1 The supervisor requires insurance intermediaries operating in its jurisdiction to be licensed.

18.1.1 In some jurisdictions other terminology such as "authorisation" or "registration", are used in place of "licensing". For the purposes of this ICP these terms are collectively referred to as "licensing".

18.1.2 The supervisor may choose to license intermediaries at the entity level or the individual level, or both. In some jurisdictions insurance intermediation activities carried out by the insurer's direct sales staff or its authorised representatives are covered by the insurer's licence; in others these may require separate intermediary licensing.

18.1.3 Where licensing is at the entity level the supervisor may consider whether the entity has in place procedures to ensure that the individuals who

conduct insurance intermediation under its responsibility meet appropriate standards of professionalism and competence. The supervisor may also wish to set its own requirements for approval of individuals, within an insurance intermediary, who conduct intermediary business.

18.1.4 Different types of insurance business involve different levels of complexity and risks and may require different levels of skill and experience in their intermediation. The supervisor may wish to specify in the licence the range of intermediation activities that it permits the insurance intermediary to undertake, taking into account, for example, the intermediary's proposed business plan and areas of expertise.

18.1.5 The licensing process should be designed to enable the supervisor to reject a licence application where it considers that the applicant will be incapable of delivering fair consumer outcomes or where it cannot be effectively supervised. For these purposes the supervisor may require an application, together with additional information that may depend on the type of licence being applied for, and may include items such as:

- details of ownership, including all information necessary to provide a full understanding of the insurance intermediary's ownership and control structure;
- a business plan, including details of proposed business and financial projections;
- the proposed sources and method of capitalisation;
- information on personnel, in particular on proposed holders of key functions;
- details of any significant third party service providers;
- details of the proposed auditor, where applicable;
- details of professional indemnity insurance cover, including amount and limitations, or comparable guarantee, where applicable;
- business continuity plans;
- if incorporated, relevant information on incorporation such as memorandum and articles of association and certificate of incorporation;
- details of policies, procedures and controls in key areas such as:
  - new business;
  - client money;
  - complaints;
  - conflicts of interest;
  - compliance;
  - combating financial crime (including AML/CFT and fraud); and

- a copy of the policy and supporting documents that govern the insurance intermediary's conduct of business, or confirmation of agreement to conduct of business rules published by the supervisor.

The supervisor may require additional information to complete the licensing process, upon request.

18.1.6 The supervisor may set minimum financial resource requirements, for example, to discourage market entrants with insufficient financial resources and to help ensure that existing licensees have sufficient financial resources for business continuity purposes. Where this is the case, such requirements might take into account factors such as the nature of the business to be intermediated, whether the intermediary operates client accounts, the level of any professional indemnity insurance and the level of operating expenses, to ensure that an appropriately risk-based financial resource requirement is set.

18.1.7 The supervisor should only issue a licence if the applicant meets the initial licensing conditions.

18.1.8 In specific and limited circumstances, the supervisor may have the power to make exceptions to certain licensing requirements. The supervisor should ensure that any such exceptions do not encourage regulatory arbitrage or increase the risk to consumers.

18.1.9 The supervisor should consider what licensing requirements are applicable to intermediaries operating on a cross-border basis from outside the jurisdiction. These requirements should be transparent to consumers, as well as to intermediaries, so that they can make an informed decision when choosing to deal with intermediaries from other jurisdictions.

18.1.10 The supervisor may consider the possibility of issuing periodically renewable licences. An advantage of doing so would be to ensure formal periodic reassessment of compliance with the regulatory licensing requirements.

18.2 The supervisor ensures that insurance intermediaries licensed in its jurisdiction are subject to ongoing supervisory review.

18.2.1 The supervisor should require that initial licensing conditions, as applicable, are maintained subsequent to the licence being issued and that ongoing regulatory requirements are met. Where another authority is responsible for setting the licensing requirements, the supervisor should communicate, and cooperate where possible, with this authority.

18.2.2 The supervisor may choose to take a risk-based approach in reviewing on a targeted basis whether insurance intermediaries fulfil their licensing and conduct of business requirements on an ongoing basis. Under such an approach, supervisory review should take into account the differing size of intermediaries, their likely impact on the market and the riskiness and complexity of their business.

18.2.3 In addition to monitoring ongoing compliance, the supervisor should require that any breaches in licensing conditions or other supervisory requirements are reported promptly.

Direct supervision

18.2.4 Direct ongoing supervision may take various forms, both off-site monitoring and on-site inspection, as necessary, as well as other supervisory tools. Further information on this topic is available in ICP 9 Supervisory Review and Reporting, but may require adaptation to make it appropriate for the specific nature of intermediary business. The balance between off-site and on-site approaches will typically be influenced by the number and nature of intermediaries in the market, as well as the supervisor's resources. The supervisor may take these factors into account when determining the balance between a proactive and reactive approach to ongoing supervision.

18.2.5 Off-site monitoring may include supervisory reporting, analysis of complaints, thematic reviews and other forms of information. The supervisor may specify information to be provided for off-site monitoring purposes, including information to be reported routinely or on an ad-hoc basis. Supervisory reporting requirements may include, but are not limited to:

- financial statements, audited where applicable, or other certification of the financial soundness of the intermediary;
- auditor's management letter, where applicable;
- confirmation of professional indemnity cover (including exclusions or limitations) or comparable guarantee;
- information on the sources of and placement of business;
- summary of movements on client money accounts, where applicable;
- changes in key functions and significant owners;
- financial links with insurers and other intermediaries (such as through related party structures or service contracts);
- types of products sold;
- business partners;
- staff compensation policy;
- incentive arrangements;
- claims data;
- complaints data; and
- details of advertising and marketing expenditure relating to particular types of products or distribution channels.

18.2.6 Where the intermediary is an employee of the insurer, the supervisor may determine that information provided by the insurer as part of the insurer's regular reporting responsibilities is sufficient, without requiring separate reporting in respect of the intermediation activities conducted by the employee of the insurer.

18.2.7 The supervisor may also use regular formal meetings with intermediaries as a means of supplementing these off-site and on-site processes and procedures. Where appropriate, the supervisor may use other tools, such as "mystery shopping", to evaluate whether the implementation of intermediaries' internal policies and procedures is resulting in fair outcomes for customers.

18.2.8 Where applicable, the supervisor should apply supervisory review processes and procedures to insurance intermediaries at the level at which licensing takes place (entity or individual level) or at the insurer level. Reporting requirements in respect of an insurer's direct sales staff would be the responsibility of the insurer.

18.2.9 On-site inspections may consider areas such as:

- corporate governance and internal controls;
- procedures and controls for combating financial crime;
- review of client money accounts where applicable;
- review of customer files;
- review of complaints;
- review of disclosure to customers and terms of business agreements;
- review of documentation of advice given and the reasons for that advice; and
- other relevant elements such as the strategy, business activities and business models, the treatment of customers, and compliance with supervisory requirements.

18.2.10 Analysis of complaints may be a valuable source of information for the supervisor, as well as for insurers and intermediaries, in identifying possible risks of poor conduct in the area of insurance intermediation.

18.2.11 The supervisor may take a risk-based approach, where greater attention is focused on higher risk areas. Examples include where:

- Insurance intermediation includes the provision of advice;
- the nature of the business intermediated is more complex;
- customers are less sophisticated; and
- there is an increased likelihood of conflicts of interest.

Indirect supervision

18.2.12 In some jurisdictions intermediaries are supervised indirectly through the supervision of the insurers. The supervisor will need to take into account the extent to which such an approach achieves effective supervision. Regardless of the approach, it is ultimately the supervisor's responsibility that intermediaries are effectively supervised.

18.2.13 An indirect approach may be more appropriate for agency intermediation rather than the broker model.

18.2.14 Indirect supervision can relate to circumstances where the insurer relies upon an intermediary to perform processes on its behalf. In such cases, written agreements could be checked by the supervisor to assess the respective responsibilities. For example, insurers are expected to obtain appropriate documentation regarding their customers to demonstrate that appropriate customer due diligence and/or fact-finding procedures have been carried out. Insurers will be assessed on the adequacy of the processes carried out and documentation obtained, including where the insurer relies upon intermediaries to perform this work and supply the documentation required.

18.2.15 Where the supervision of intermediaries is undertaken indirectly, the supervisor should assess the insurer's processes to monitor the work undertaken by an intermediary on its behalf.

Self-regulatory organisations

18.2.16 A self-regulatory organisation (SRO) can be described as a non-government organisation that has the power to create and enforce industry or professional regulations and standards. The self-regulatory functions of an SRO can contribute to the supervision of intermediaries through the requirements for, and enforcement of, professional standards for its members.

18.2.17 In jurisdictions with an SRO for intermediaries, the supervisor should assess whether the SRO meets appropriate standards before placing any reliance on the SRO's self-regulatory functions. The supervisor's assessment should consider matters such as whether the SRO:

- has sufficient independence;
- has appropriate powers and resources to fulfil its mission and provide effective self-regulation;
- performs its self-regulatory functions adequately;
- establishes and maintains standards that are sufficiently robust; and
- takes appropriate action to deal with any shortcomings.

18.2.18 An SRO's regulations and standards may not address all the aspects of the supervision of insurance intermediaries for which the supervisor has responsibility. Therefore, whilst the supervisor may choose to place some reliance on the self-regulatory functions of an SRO, the supervisor should retain overall responsibility for supervision.

Other

18.2.19 In addition to direct and indirect supervision of intermediaries, the supervisor may use the supervision of insurers to gather information on and, to some extent, monitor intermediaries' activities. This may include, for example, identifying whether particular intermediaries or particular matters are the subject of regular or frequent complaints.

18.3 The supervisor requires insurance intermediaries to maintain appropriate levels of professional knowledge and experience, integrity and competence.

Professional knowledge and experience

18.3.1 It is important that individuals carrying out the activity of insurance intermediation have adequate professional knowledge. Professional knowledge can be gained from experience, education and/or training. The attainment of relevant professional qualifications may demonstrate that a certain level of professional knowledge has been achieved.

18.3.2 The supervisor should require that individuals carrying out the activity of insurance intermediation have professional knowledge and experience appropriate for the business which they intermediate. More complex products or customer needs may require higher or more specialised knowledge and experience. The knowledge and experience of individuals should also be appropriate for the type of business being intermediated. Once professional qualifications have been achieved, it is important that individuals who continue to carry out the activity of insurance intermediation keep their professional knowledge up to date. In some jurisdictions, there are supervisory or statutory requirements that individuals carrying out the activity of insurance intermediation should spend a specified minimum amount of time on continuous professional development. In some jurisdictions, professional bodies impose such a requirement on their members.

18.3.3 The supervisor may consider recognising the qualifications of specified professional bodies. Where a jurisdiction has no such professional body, consideration could be given to encouraging or recognising qualifications obtained through professional bodies in other jurisdictions. The supervisor may also consider recognising such qualifications where these are considered to be equivalent to, or exceed, the qualifications available within the jurisdiction.

18.3.4 Intermediaries should be knowledgeable regarding the status of the insurers whose products they sell. For example, they should be satisfied that the insurer is licensed to sell insurance in the relevant jurisdiction, as a branch or subsidiary, and should be aware of the financial status and credit rating of the insurer and the applicability of any policyholder protection schemes to that insurer's products.

Integrity

18.3.5 It is essential that those carrying out the activity of insurance intermediation act with integrity and high ethical standards. These relate to the behaviour of the individuals concerned, such as:

- being honest, trustworthy and open;
- being reliable, dependable and respectful;
- not taking unfair advantage;
- not accepting or offering gifts where this might imply an improper obligation.

18.3.6 The supervisor may require individuals carrying out the activity of insurance intermediation to be subject either to their organisation's

internal policies and procedures, or to the ethical standards of professional bodies, that require integrity.

18.3.7 The supervisor may establish its own expectations on integrity through, for example, the publication of codes of conduct with which such individuals are required to comply. Codes of conduct should be complementary to the relevant legislation and may address any aspect of dealings between insurance intermediaries and their customers.

18.3.8 Intermediary organisations should have procedures to assess the integrity of those intermediating on their behalf. Such procedures should include pre-employment checks as well as ongoing requirements. Pre-employment checks should include, amongst other things, employment history, any civil liability, criminal convictions, administrative actions by regulatory agencies and self-regulatory organisations, or pending legal proceedings.

Competence

18.3.9 The supervisor should require individuals carrying out the activity of insurance intermediation to act only in respect of business for which they have the required competence.

18.3.10 The supervisor should require insurance intermediaries to implement policies and procedures to assess the competence of individuals carrying out the activity of insurance intermediation. Assessment would be particularly important in the case of new employees or where staff are assigned different or more challenging responsibilities. Competence should also be monitored as an ongoing process for all relevant staff. This may include actions such as:

- observed interviews with customers;
- review of customer files;
- internal interviews; and/or
- coaching.

18.3.11 An on-site inspection may provide an opportunity for the supervisor to assess competence, such as through file reviews and interviews of selected staff.

Role of professional standards

18.3.12 SROs and other professional bodies can be instrumental in promoting professional standards where they issue standards or codes with which their members are required to comply. Standards required by relevant SROs or other professional bodies might include areas such as:

- acting with high ethical standards and integrity;
- acting in the best interests of each client;
- providing a high standard of service; and
- treating customers fairly.

18.3.13 Members of an SRO or other professional body who are found to be in breach of its professional standards may be subject to disciplinary procedures such as suspension of, or exclusion from, membership.

18.3.14 In jurisdictions where there is reliance on the membership of a professional body, the supervisor may consider confirming that such a body has an effective disciplinary scheme in force. The supervisor may nevertheless decide not to depend on such professional processes entirely and deal with issues of an individual's professional conduct directly.

18.4 The supervisor requires that insurance intermediaries apply appropriate governance.

18.4.1 An insurance intermediary's governance framework may vary, depending upon the nature and scale of the intermediary and the complexity of its business, and may be subject to general company law. However, each intermediary's governance framework should be sufficient to provide for sound and prudent management of the business and to support the fair treatment of customers.

18.4.2 In setting relevant governance requirements the supervisor should consider the application of such requirements to sole traders and small businesses operating as insurance intermediaries. Such requirements for sole traders and small businesses will differ from those for larger entities. Key areas where requirements may vary include internal controls, segregation of duties, and compliance functions. Regardless, the supervisor should be satisfied that a sound level of governance is achieved and that there are no unacceptable risks, with the overriding objective that customers are appropriately protected.

18.4.3 Good governance may be promoted by the supervisor, as well as other authorities, professional bodies and SROs, by publishing guidance (for example, a Code of Practice) for insurance intermediaries on their obligations in respect of governance-related matters. Guidance that may help intermediaries meet governance requirements may include matters such as:

- ensuring that those responsible for the intermediary organisation's governance have the competence and integrity to fulfil their respective roles;
- ensuring appropriate standards for conduct of business;
- ensuring there is regular monitoring of consumer outcomes;
- ensuring that the making of key decisions is subject to sufficient discussion at Board level or with key persons in control functions as appropriate;
- ensuring adequate human resources to conduct the business;
- ensuring an appropriate level of internal controls of the business;
- ensuring appropriate disciplinary policies and procedures for wrongdoing are in place;

- maintaining adequate files and records and ensuring their availability for inspection;
- maintaining appropriate controls over outsourced functions; and
- compliance with all relevant legislation, including non-insurance legislation such as in respect of anti-money laundering, fraud, etc.

18.4.4 Relevant to governance, intermediaries are required to establish and implement policies and procedures on the fair treatment of customers that are an integral part of their business culture (see Standard 19.2).

18.4.5 The governance of an insurer's direct sales staff is the responsibility of the insurer, and the governance of insurers is the subject of ICP 7 Corporate Governance. Although ICP 7 is otherwise not directly applicable to intermediaries, it may be a useful source of information for intermediary supervisors.

18.5 The supervisor requires insurance intermediaries to disclose to customers, at a minimum:

- **the terms and conditions of business between themselves and the customer;**
- **the relationship they have with the insurers with whom they deal; and**
- **information on the basis on which they are remunerated where a potential conflict of interest exists.**

18.5.1 In addition to disclosing matters relating to intermediaries themselves, intermediaries are required to disclose information on insurance products offered to customers (see Standards 19.5 and 19.6).

18.5.2 In setting disclosure requirements, the supervisor may take into account that there are differences in:

- the nature of different insurance products;
- the level of sophistication of different customers; and
- the way in which different types of insurance are transacted (for example, differences between commercial and personal (retail) lines).

The nature, timing and detail of disclosures may differ according to the circumstances. Nevertheless, disclosure requirements should provide adequate information to customers, taking into account these factors.

Terms of business

18.5.3 A terms of business agreement may be a convenient means by which an insurance intermediary can provide important information to a customer and satisfy many of the disclosure requirements. Such a document may include information such as:

- by whom they are licensed and supervised;
- the type of business for which they are licensed;

- whether they are independent or act on behalf of one or more insurers;
- information on the basis on which they are remunerated;
- the services provided, including whether they offer products from a full range of insurers, from a limited range or from a single insurer;
- charging arrangements for the intermediation services;
- cancellation rights in respect of the intermediation services;
- notification of complaints;
- client money arrangements, including treatment of interest;
- confidentiality of information provided; and
- the relevant law governing the agreement.

18.5.4 Insurance intermediaries should provide information on terms of business to customers and do so prior to an insurance contract being entered into. Where there is an ongoing business relationship between an intermediary and a customer, or once terms of business information has initially been provided in the case of policy renewals, the intermediary should review whether reiterating this information is necessary. Further information on terms of business might only be necessary where there are changes to the terms.

18.5.5 When insurance cover needs to be arranged immediately it may not be possible to provide documentation of terms of business at the point of arranging the contract. In such situations the information may be provided orally and followed up with written documentation within a reasonable period of time.

18.5.6 The supervisor may recommend, or require, that a copy of the terms of business, signed by the customer, is retained as part of the insurance intermediary's records. Where insurance is intermediated over the internet, the customer may be required to acknowledge the terms of business before a policy can be proceeded with. Electronic records should also be retained by the intermediary.

Intermediary status

18.5.7 An insurance intermediary's status may provide information to a customer on the extent of products from which recommendations are made and provide an indication of potential conflicts of interest. Where the insurance intermediary is only able to select products from a single insurer or from a limited range, the customer may wish to carry out their own research to see whether they can obtain better terms or a more suitable product elsewhere in the market.

18.5.8 It is particularly important that insurance intermediaries provide customers with information on their relationship with the insurers with whom they deal, specifically whether they are independent or act for one or more insurance companies, and whether they are authorised to conclude insurance contracts on behalf of an insurer or not.

18.5.9 Potential conflicts of interest can arise for some intermediaries if the intermediary is part of a wider group or if the intermediary has a financial interest, such as a shareholding, in an insurer or insurance group. Such relationships should be disclosed to customers.

18.5.10 Information on the insurance intermediary's status may be provided as part of a terms of business agreement or separately. Because of its importance, this information may also be highlighted verbally to the customer.

Remuneration

18.5.11 Insurance intermediaries are generally remunerated by way of fees and commissions, such as:

- fees paid directly by the customer;
- fees or commissions paid indirectly by the customer, by way of deduction from premiums or funds invested; or
- fees or commissions paid by the insurer.

18.5.12 Where insurers' direct sales staff carry out insurance intermediation as employees of the insurer, they may be salaried as well as receive any applicable commission.

18.5.13 Information on charging structures may be important information to customers. For example, for insurance products with an investment element, information on any fees or other costs deducted from the initial amount invested, as well as on fees or commissions deducted from the investment thereafter will be important.

18.5.14 Information on charging may be provided as part of a terms of business agreement, or separately. As fees and commissions vary by product and between product providers, they may need to be provided separately for each product recommended, often by inclusion in product documentation. Given their significance to some types of product, this information might also be highlighted verbally to the customer.

18.5.15 The supervisor may also require that, upon a customer's request to the intermediary, the customer is provided with further information on fees and commissions, including the level of fees and commissions. The intermediary should make the customer aware of his/her right to request information on fees and commissions. Communication should be clear and not misleading. In view of the impact of fees and commissions upon insurance products with an investment element, the supervisor may require that disclosure of fees and commissions is provided to customers prior to contracts being entered into in respect of all such products.

18.5.16 Some forms of remuneration of insurance intermediaries potentially lead to a conflict of interest. For example, an intermediary may be tempted to recommend a product which provides higher fees or commissions than another. Potential conflicts of interest for intermediaries may exist in a variety of circumstances (see ICP 19 Conduct of Business).

18.5.17 The supervisor should be satisfied that the intermediary has robust procedures in place to identify and avoid, or manage, conflicts of interest,

and deliver outcomes aligned with customers' best interests. Where they cannot be avoided, or managed satisfactorily, this would result in the intermediary declining to act. Conflicts of interest may be managed or avoided in different ways depending on the nature and severity of the conflict of interest (discussed further in Application Paper on Supervising the Conduct of Intermediaries).

Additionally, circumstances in which conflicts of interest may arise may be covered in the codes of conduct issued by SROs or other professional bodies.

18.5.18 The supervisor should be aware of the use of non-monetary benefits, including, for example, "soft" commissions, offered by insurers to intermediaries. These may include less tangible inducements such as professional support, IT support, or corporate entertainment at sporting or cultural events. Such inducements may lead to conflicts of interest and are less transparent than fees or commissions and also need to be avoided, managed or prohibited as appropriate.

18.6 The supervisor requires an insurance intermediary who handles client monies to have safeguards in place to protect these funds.

18.6.1 In the course of carrying out its business, an insurance intermediary may:

- receive monies from a client for the payment of premiums to an insurer; and/or
- receive monies from an insurer in respect of claims or refunded premiums for onward payment to a client.

18.6.2 Some jurisdictions have specific legal requirements in respect of the cash flows where monies are transferred via an intermediary from the customer to the insurer, and vice versa, including in determining whether the customer or the insurer is at risk in respect of such funds.

18.6.3 Where funds are held at the risk of the client, they may be referred to as "client monies" or "client's money". The intermediary should have adequate policies and procedures in place for the safeguarding of such funds in the interests of their customers.

18.6.4 In some jurisdictions, premiums are deemed to have been paid to the insurer as soon as the customer pays premiums to the intermediary. In these circumstances the insurer, rather than the customer, bears the risk of allowing intermediaries to collect premiums on its behalf.

18.6.5 The supervisor may require that an insurance intermediary's client money policies and procedures cover matters such as the following:

- client accounts are separate and clearly distinguishable from the intermediary's own bank accounts;
- client accounts are held with licensed banks within the jurisdiction, or specified other jurisdictions;
- disallowing monies other than client monies within the account, except in specific circumstances such as to achieve or maintain a minimum balance, to receive interest, or to receive commission due to the intermediary;

- monies are paid into the account promptly;
- adequate financial systems and controls are maintained, including authorisation of payments from the account;
- adequate books and records are maintained and subject to audit;
- reconciliations are performed on a regular basis and reviewed;
- discrepancies on the account are followed up promptly and resolved satisfactorily;
- for each client, payments from a client account are not made before sufficient monies paid into the account have cleared, thus ensuring that any balance held in respect of each client is not negative; and
- the treatment of interest.

18.6.6 In the interest of safeguarding clients' money, it is important that client accounts cannot be used to reimburse creditors of the insurance intermediary.

18.6.7 Where insurance intermediaries operate client accounts, the supervisor may require that the terms and conditions of such accounts are disclosed to their customers, including whether funds held in such accounts are at the risk of clients or at the risk of the insurer.

18.7 Where appropriate, the supervisor takes supervisory measures against licensed insurance intermediaries.

18.7.1 The supervisor should initiate measures to prevent or respond to poor conduct or breaches of regulatory requirements by an intermediary, with a view to mitigating adverse outcomes for customers. Where necessary, the supervisor may use sanctions.

18.7.2 The supervisory framework should allow for the exercise of judgement and discretion, and provide flexibility in the use of preventive measures, corrective measure and sanctions.

18.7.3 In some instances, the supervisor may need to work with other relevant authorities or bodies in order to take or enforce supervisory measures or sanctions against an intermediary.

Preventive measures

18.7.4 Where the supervisor assesses that there may be a significant risk of an insurance intermediary breaching supervisory requirements or to consumer or policyholder interests in general, it should require insurance intermediaries to take appropriate measures to mitigate both market-wide risks as well as risks from specific entities or individuals.

18.7.5 In this regard, the supervisor may take proactive measures, such as publishing guidance on good practices or warnings to the industry or consumers.

Corrective measures

18.7.6 Where the insurance intermediary fails to meet supervisory requirements, or where consumers may otherwise be at risk, the supervisor should require corrective measures to be taken by the insurance intermediary. This may occur, for example, where:

- there is evidence of unfair treatment;
- required information is not provided to customers;
- policies and procedures are inadequate (particularly where this results in inadequate due diligence work);
- internal controls, file keeping or documentation are inadequate;
- conflicts of interest are not adequately identified or managed; or
- there are concerns over business continuity.

18.7.7 Supervisory measures should apply at either the entity level or individual level, as appropriate. These may include, for example:

- requiring the implementation of enhanced policies and procedures;
- requiring further training;
- restricting business activities;
- suspending or barring specific individuals from engaging in intermediary business or being responsible for the corporate governance of an intermediary organisation; or
- suspending, revoking or not renewing the licence.

Sanctions

18.7.8 Where appropriate, the supervisor should impose sanctions on entities or individuals. The range of sanctions may include, for example:

- imposing fines;
- barring individuals from acting in key roles or holding similar roles in the future; or
- requiring remediation, including compensation to policyholders where appropriate.

18.7.9 Sanctions imposed should be commensurate with the nature and severity of the shortcomings. Minor offences may be dealt with through oral or written communications with the intermediary's management and then followed up, whereas more significant deficiencies may warrant immediate or more significant action.

18.7.10 Jurisdictions should provide due process for an intermediary to appeal supervisory measures.

18.8 The supervisor checks that the intermediary is taking the measures required and escalates such measures if its concerns are not being addressed.

18.8.1 The supervisor should review the results of measures that it has required of an intermediary and the effectiveness of the actions taken.

18.8.2 If the action taken by the intermediary does not adequately address the supervisor's concern, the supervisor should require further measures.

18.8.3 Supervisory measures should be escalated in line with the supervisor's concern about the intermediary and the risk to consumers.

18.9 The supervisor takes measures against individuals or entities that conduct insurance intermediation without the necessary licence.

18.9.1 The supervisor should have in place mechanisms to identify when unlicensed insurance intermediation is being carried out. Examples of such mechanisms include monitoring media and advertising, review of consumer complaints and encouraging industry and other stakeholders to notify the supervisor of suspicious activity.

18.9.2 When unlicensed insurance intermediation is identified, the supervisor should act to address the issue. Examples include seeking court orders to require the unlicensed individual or entity to stop the activity, informing law enforcement authorities of criminal and/or civil concerns, and publicising the fact that the individual/entity is not licensed to conduct insurance intermediation.

ICP 19 Conduct of Business[76]

The supervisor requires that insurers and intermediaries, in their conduct of insurance business, treat customers fairly, both before a contract is entered into and through to the point at which all obligations under a contract have been satisfied.

Introductory Guidance

19.0.1 Requirements for the conduct of insurance business help to:

- protect policyholders and promote fair consumer outcomes;
- strengthen public trust and consumer confidence in the insurance sector;
- minimise the risk of insurers and intermediaries following business models that are unsustainable or pose reputational risk, thereby complementing the risk management framework of a solvency regime; and
- support a sound and resilient insurance sector by creating level playing fields in terms of the basis on which insurers and intermediaries can compete while maintaining business practices that support the fair treatment of customers.

19.0.2 Fair treatment of customers encompasses achieving outcomes such as:

- developing, marketing and selling products in a way that pays due regard to the interests and needs of customers;
- providing customers with information before, during and after the point of sale that is accurate, clear, and not misleading;
- minimising the risk of sales which are not appropriate to customers' interests and needs;
- ensuring that any advice given is of a high quality;
- dealing with customer claims, complaints and disputes in a fair and timely manner; and
- protecting the privacy of information obtained from customers.

19.0.3 Conduct of business, including business practices, is closely linked with jurisdictions' tradition, culture, legal regime and the degree of development of the insurance sector. For this reason, supervisory approaches to the conduct of business also tend to vary. Such diversity should be taken into consideration in implementing this ICP, and related standards and guidance material, in order to achieve the outcome of fair treatment of customers. The fair treatment of customers

[76] Amended November 2017

encompasses concepts such as ethical behaviour, acting in good faith and the prohibition of abusive practices.

19.0.4 Requirements for the conduct of insurance business may differ depending on the nature of the customer with whom an insurer or intermediary interacts and the type of insurance provided. The scope of requirements for conduct of insurance business should reflect the risk of unfair treatment of customers, taking into account the nature of the customer and the type of insurance provided.

19.0.5 As part of assessing the fulfilment of requirements for conduct of insurance business, the supervisor should consider the consumer outcomes that are being achieved under these requirements. This includes consumer outcomes that arise due to industry-wide – as well as firm-specific – factors.

19.0.6 Supervisors may wish to issue guidelines or rules on their expectations to help insurers and intermediaries achieve fair treatment of customers. In addition, the supervisor could support industry guidelines or best practices with this objective.

19.0.7 Detailed conduct of business rules may not be appropriate for reinsurance transactions, where benefits under a policy are not affected by the reinsurance arrangements (see ICP 13 Reinsurance and Other Forms of Risk Transfer). Nonetheless, this does not relieve insurers and reinsurers of their duty to provide each other with complete and accurate information.

Respective responsibilities

19.0.8 The insurer has a responsibility for good conduct throughout the insurance life-cycle, as it is the insurer that is the ultimate risk carrier. However, where more than one party is involved in the design, marketing, distribution and policy servicing of insurance products, the good conduct in respect of the relevant service(s) is a shared responsibility of those involved.

19.0.9 Intermediaries typically play a significant role in insurance distribution but may also be involved in other areas. Their interface between customers and insurers gives them a key role, and their good conduct in performing the services in which they are involved is critical in building and justifying public trust and confidence in the insurance sector.

19.0.10 Insurers sometimes outsource specific processes, such as claims handling, to third parties (including intermediaries). Where an insurer outsources processes, the insurer should only deal with third parties whose policies, procedures and processes are expected to result in fair treatment of customers; the insurer retains ultimately responsibility for those functions.

Cross-border and group considerations

19.0.11 Legislation should provide requirements with which insurers and intermediaries must comply, including foreign insurers and intermediaries selling products on a cross-border basis.

19.0.12 Effective assessment of the quality of conduct of insurance business requires, to a large extent, supervisory consideration of strategies, policies, processes, procedures and controls that apply to the provision of insurance products and services to customers, and which are more easily assessed through supervision at the insurance legal entity, rather than group, level.

19.0.13 Where insurance legal entities are part of an insurance group, the application of appropriate policies and procedures on conduct of business should be consistent across the group, recognising local requirements and specificities, and should result in the fair treatment of customers on a group-wide basis. In addition, there are a number of other group-related aspects that are relevant to the supervision of conduct of business by insurers and intermediaries, such as:

- public disclosure by the supervisor of the regulatory requirements in respect of the offering of cross-border insurance;
- disclosure to customers of the group to which an underwriter belongs; and
- the potential risks from group entities that could affect policies being sold or administered.

The supervisor should consider the implications arising from group structures in applying the Standards of this ICP.

Supervisory cooperation

19.0.14 Supervisors should be aware of the conduct of business requirements set by the regulators of other financial services sectors with a view to minimising unnecessary inconsistencies, possible duplication and the potential for regulatory arbitrage.

19.0.15 In some jurisdictions responsibility for the supervision of insurers or intermediaries is shared between more than one authority, or between different departments within a single authority, with different authorities or departments responsible for conduct and prudential supervision. Where this is the case, the relevant authorities or departments should communicate, and cooperate where possible, to ensure that there is an understanding of all the relevant risks.

19.0.16 The supervisor should also consider having in place adequate coordination arrangements to deal with conduct of business issues arising in cross-border business.

Fair treatment of customers

19.1 The supervisor requires insurers and intermediaries to act with due skill, care and diligence when dealing with customers.

19.1.1 The supervisor should require insurers and intermediaries to have policies and procedures in place to achieve this outcome, including taking appropriate measures to ensure that their employees and agents meet high standards of ethics and integrity.

19.2 The supervisor requires insurers and intermediaries to establish and implement policies and procedures on the fair treatment of customers, as an integral part of their business culture.

19.2.1 Supervisors should require insurers and intermediaries to have policies and procedures in place to achieve the fair treatment of customers and should monitor whether such policies and procedures are adhered to.

19.2.2 Proper policies and procedures dealing with the fair treatment of customers are likely to be particularly important with respect to retail customers, because of the greater asymmetry of information that tends to exist between the insurer or intermediary and the individual retail customer.

19.2.3 Supervisory requirements with respect to fair treatment of customers may vary depending on the legal framework in place in a particular jurisdiction. The desired outcome of fair treatment of customers may be achieved through a variety of approaches, with some jurisdictions favouring a principles-based set of requirements, some favouring a rules-based approach, and others following some combination of approaches.

19.2.4 Ensuring the achievement of fair outcomes for customers will tend to require that insurers and intermediaries adopt the fair treatment of customers as an integral part of their business culture, and that policies and procedures to support this objective are properly embedded in the organisation. Embedding a culture of fair treatment of customers may include the following:

- Strategy: Fair treatment of customers should be an objective taken into consideration in the design of the business strategy, product design, product distribution, and product performance.
- Leadership: Overall responsibility for fair treatment of customers should be at the level of the Board and Senior Management, who should design, implement, and monitor adherence to, policies and procedures aimed at ensuring that customers are treated fairly. This sets the tone for the business.
- Decision making: All decisions that impact on customers should be subject to particular scrutiny in terms of whether they support the fair treatment of customers.
- Internal controls: Monitoring the fair treatment of customers requires relevant management information to be identified, collected and evaluated. Internal reports should include the most useful information and indicators to allow the Board and Senior Management to measure the insurer's or intermediary's performance with respect to fair treatment of customers. Mechanisms and controls should be established to ensure that departures from policies and procedures as well as other

situations that jeopardise the interests of customers, are promptly remedied.

- Performance management: Appropriate attention should be paid to the recruitment of staff and agents who meet high standards of ethics and integrity. Relevant staff should be trained to deliver appropriate outcomes in terms of fair treatment of customers. Evaluation of performance should include the contribution made to achieving these outcomes. There should be appropriate performance management consequences for staff who fail to meet these standards.
- Reward: Remuneration and reward strategies should take account of the fair treatment of customers. Reward structures need to reflect quality issues and not encourage or reward the unfair treatment of customers. Remuneration structures that create conflicts of interest may lead to poor customer outcomes.

19.2.5 Insurers' and intermediaries' strategies, policies and procedures dealing with the fair treatment of customers should be made available to the supervisor. The supervisor should encourage insurers and intermediaries to make relevant policies and procedures publicly available as good practice, in particular their claims handling, complaints handling and dispute resolution policies and procedures.

19.3 The supervisor requires insurers and intermediaries to avoid or properly manage any potential conflicts of interest.

19.3.1 In their dealings either with each other or with customers, insurers and intermediaries may encounter conflicts of interest.

19.3.2 Where conflicting interests compete with duties of care owed to customers, they can create risks that insurers and intermediaries will not act in customers' best interests. Conflicts of interest can arise from compensation structures as well as other financial and non-financial incentives.

19.3.3 Where compensation structures do not align the interests of the insurer and intermediary, including those of the individuals carrying out intermediation activity, with the interests of the customer, they can encourage behaviour that results in unsuitable sales or other breach of the insurer's or intermediary's duty of care towards the customer.

19.3.4 Other incentives that may create a conflict of interest include performance targets or performance management criteria that are insufficiently linked to customer outcomes. They also include the soliciting or accepting of inducements where this would conflict with the insurer's or intermediary's duty of care towards its customers.

19.3.5 An inducement can be defined as a benefit offered to an insurer or intermediary, or any person acting on its behalf, incentivising that firm/person to adopt a particular course of action. This can include, but is not limited to, cash, cash equivalents, commission, goods and hospitality. Where intermediaries who represent the interests of customers receive inducements from insurers, this could result in a conflict of interest that could affect the independence of advice given by them.

19.3.6 As an insurance intermediary interacts with both the customer and the insurer, an intermediary is more likely than an insurer to encounter conflicts of interest. For an insurance intermediary, examples of where a conflict of interest may occur include:

- where the intermediary owes a duty to two or more customers in respect of the same or related matters – the intermediary may be unable to act in the best interests of one without adversely affecting the interests of the other;
- where the relationship with a party other than the customer influences the advice given to the customer;
- where the intermediary is likely to make a financial gain, or avoid a financial loss, at the expense of the customer;
- where the intermediary has an interest in the outcome of a service provided to, or a transaction carried out on behalf of, a customer which is distinct from the customer's interest;
- where the intermediary has significant influence over the customer's decision (such as in an employment relationship) and the intermediary's interest is distinct from that of the customer;
- where the intermediary receives an inducement to provide a service to a customer other than the standard or "flat" fee or commission for that service; and
- where the intermediary has an indirect interest in the outcome of a service provided to, or a transaction carried out on behalf of, a customer due to an association with the party that directly benefits (such as soliciting insurance products which are sold together with other financial services in a bancassurance relationship) and where such indirect interest is distinct from the customer's interest (such as the cross-selling or self-placement of business).

19.3.7 The supervisor should require that insurers and intermediaries take all reasonable steps to identify and avoid or manage conflicts of interest, and communicate these through appropriate policies and procedures.

19.3.8 Appropriate disclosure can provide an indication of potential conflicts of interests, enabling the customer to determine whether the sale may be influenced by financial or non-financial incentives. It can thus help in managing conflicts of interest where it empowers consumers to identify and challenge or avoid potentially poor advice or selling that may arise through the conflict of interest. However, managing conflicts of interest through disclosure or obtaining informed consent from customers, has limitations, including where the customer does not fully appreciate the conflict or its implications, and could be seen to place an unreasonable onus on the customer.

19.3.9 Where conflicts of interest cannot be managed satisfactorily, this should result in the insurer or intermediary declining to act. In cases where the supervisor may have concerns about the ability of insurers

and intermediaries to manage conflicts of interest adequately, the supervisor may consider requiring other measures.

19.4 The supervisor requires insurers and intermediaries to have arrangements in place in dealing with each other to ensure the fair treatment of customers.

19.4.1 The supervisor should require insurers to conduct business only with intermediaries that are licensed, and to verify that the intermediaries under such arrangements have the appropriate knowledge and ability with which to conduct such business.

19.4.2 The supervisor may require insurers to report any significant issues of which they become aware and have transparent mechanisms to handle complaints against intermediaries. This might include identifying whether particular intermediaries or particular matters are the subject of regular or frequent complaints. Documentation on this will enable insurers to report recurring issues to the supervisor where the matters identified may be relevant to the supervisor's assessment of the intermediaries concerned.

19.4.3 Supervisory measures to prevent or respond to a breach of regulatory requirements by an intermediary may include action against insurers in the case of direct sales or where an insurer knowingly cooperates with an intermediary that is in breach of its regulatory requirements.

19.4.4 Insurers and intermediaries should ensure that written agreements are established in respect of their business dealings with each other, to clarify their respective roles and promote the fair treatment of customers. Such agreements would include, where relevant, respective responsibilities on matters such as:

- product development;
- product promotion;
- the provision of pre-contractual and point of sale information to customers;
- post-sale policy servicing;
- claims notification and handling;
- complaints notification and handling;
- management information and other documentation required by the insurer;
- remedial measures; and
- any other matters related to the relationship with customers.

Product development and pre-contractual stage

19.5 The supervisor requires insurers to take into account the interests of different types of consumers when developing and distributing insurance products.

19.5.1 This can be achieved through a product approval approach, a "principles-based" approach or a combination of both. In a product approval approach, the supervisor requires insurers to submit insurance product proposals for supervisory review and approval prior

to product launch. In a "principles-based" approach, the onus is placed on the insurer's Board and Senior Management to ensure that products and distribution strategies are developed in accordance with the principles.

19.5.2 In some cases, product development is undertaken by intermediaries on behalf of insurers for whom they act. In such cases, the intermediaries involved are responsible for taking customers' interests and needs into account in performing this work. Nevertheless, the insurer should retain oversight of, and remains accountable for, the development of its products and its distribution strategies.

Product approval approach

19.5.3 Where supervisors have the power to approve contract conditions or pricing, the approval process should balance the protection of customers against the potential benefits to customers of innovation and choice in insurance products. For example, supervisory approval of contract conditions or pricing is likely to be more appropriate in certain circumstances, such as where the insurer is dealing with less financially-capable or vulnerable customers, where products are new to the market or complex, or insurance contracts that are required by law such as automobile liability insurance or health insurance.

19.5.4 In such situations the supervisor may review products for compliance with things such as:

- mandated policy limits;
- coverage of specified risks, procedures or conditions;
- absence of prohibited exclusions; and
- compliance with specifically required policy language.

Principles-based approach

19.5.5 Where supervisors follow a more principles-based approach, supervisors may issue guidance in terms of what is expected of insurers and intermediaries. This may include the following:

- Development of products and distribution strategies should include the use of adequate information to assess the needs of different consumer groups.
- Product development (including a product originating from a third party) should provide for a thorough assessment of the main characteristics of a new product and of the related disclosure documents by every appropriate department of the insurer.
- Before bringing a product or service to the market, the insurer should carry out a diligent review and testing of the product in relation to its business model, the existing rules and regulations and its risk management approach. In particular, the policies, procedures and controls put into place should enable the insurer to:

- offer a product that delivers the reasonably expected benefits;
- target the consumers for whose needs the product is likely to be appropriate, while preventing, or limiting, access by consumers for whom the product is likely to be inappropriate;
- ensure that distribution methods are appropriate for the product, particularly in light of the legislation in force and whether or not advice should be provided;
- assess the risks resulting from the product by considering, among other things, changes associated with the environment or stemming from the insurer's policies that could harm customers; and
- monitor a product after its launch to ensure it still meets the needs of target customers, assess the performance of the various methods of distribution used with respect to sound commercial practices and, if necessary, take the necessary remedial action.

- Insurers should provide relevant information to intermediaries to ensure that they understand the target market (and thus reduce the risk of mis-selling), such as information related to the target market itself, as well as the characteristics of the product.
- The intermediary should, in return, provide information to the insurer on the types of customers to whom the product is sold and whether the product meets the needs of that target market, in order to enable the insurer to assess whether its target market is appropriate and to revise its distribution strategy for the product, or the product itself, when needed

19.5.6 Supervisors may require insurers to submit specific information relating to the manner in which the development of insurance products complies with the legislated principles at any time, including prior to the launch of the product (pre-notification).

19.6 The supervisor requires insurers and intermediaries to promote products and services in a manner that is clear, fair and not misleading.

19.6.1 The insurer should be responsible for providing promotional material that is accurate, clear and not misleading not only to customers but also to intermediaries who may rely on such information.

19.6.2 Before an insurer or intermediary promotes an insurance product, it should take reasonable steps to ensure that the information provided is accurate, clear and not misleading. Procedures should provide for an independent review of promotional material intended for customers other than by the person or organisation that prepared or designed it. For example, where promotional material is developed by an intermediary on behalf of an insurer, the insurer should verify the accuracy of promotional material before it is used.

19.6.3 If an insurer or intermediary becomes aware that the promotional material is not accurate and clear or is misleading, it should:

- inform the insurer or intermediary responsible for that material;
- withdraw the material; and
- notify any person that it knows to be relying on the information as soon as reasonably practicable.

19.6.4 In addition, to promote products in a fair manner, the information provided by an insurer or intermediary should:

- be easily understandable;
- accurately identify the product provider;
- be consistent with the coverage offered;
- be consistent with the result reasonably expected to be achieved by the customers of that product;
- state prominently the basis for any claimed benefits and any significant limitations; and
- not hide, diminish or obscure important statements or warnings.

19.7 The supervisor requires insurers and intermediaries to provide timely, clear and adequate pre-contractual and contractual information to customers.

19.7.1 The insurer or intermediary should take reasonable steps to ensure that a customer is given appropriate information about a product in order that the customer can make an informed decision about the arrangements proposed. Such information is also useful in helping customers understand their rights and obligations after sale.

19.7.2 Where insurers use intermediaries for the distribution of insurance products, the insurer should be satisfied that the intermediaries involved are providing information to customers in a manner that will assist them in making an informed decision.

Timing of the provision of information to customers

19.7.3 Customers should be appropriately informed before and at the point of sale. Information should enable an informed decision to be made by the customer before entering into a contract. In determining what is "timely", an insurer or intermediary should consider the importance of the information to the customer's decision-making process and the point at which the information may be most useful.

Clear delivery of information to customers

19.7.4 Information should be provided in a way that is clear, fair and not misleading. Wherever possible, attempts should be made to use plain language that can easily be understood by the customer.

19.7.5 Mandatory information should be prepared in written format, on paper or in a durable and accessible medium (electronic, for instance).

19.7.6 Focus should be on the quality rather than quantity of information, as there is a risk that if the disclosure becomes too voluminous then the customer may be less likely to read the information.

19.7.7 The quality of disclosure may also be improved by the introduction of a standardised format for disclosure (such as a product information sheet), which will aid comparability across competing products and allow for a more informed choice. Standard formats should be tested to ensure that they help understandability.

19.7.8 There is likely to be an enhanced need for clear and simple disclosure for more complex or "bundled" products, which are difficult for consumers to understand, such as packaged retail insurance-based investment products (PRIIPS), particularly regarding the costs, risks involved and performance.

19.7.9 Insurers and intermediaries should be able to demonstrate to the supervisor that customers have received information necessary to understand the product.

Adequacy of information provided to customers

19.7.10 The information provided should be sufficient to enable customers to understand the characteristics of the product they are buying and help them understand whether and why it may meet their requirements.

19.7.11 The level of information required will tend to vary according to matters such as:

- the knowledge and experience of a typical customer for the policy in question;
- the policy terms and conditions, including its main benefits, exclusions, limitations, conditions and its duration;
- the policy's overall complexity;
- whether the policy is bought in connection with other goods and services; and
- whether the same information has been provided to the customer previously and, if so, when.

Disclosure of product features

19.7.12 While the level of product information required may vary, it should include information on key features, such as:

- the name of the insurer, its legal form and, where relevant, the group to which it belongs;
- the type of insurance contract on offer, including the policy benefits;
- a description of the risk insured by the contract and of the excluded risks;

- the level of the premium, the due-date and the period for which the premium is payable, the consequences of late or non-payment, and provisions for premium reviews;
- the type and level of charges to be deducted from or added to the quoted premium, and any charges to be paid directly by the customer;
- when the insurance cover begins and ends; and
- prominent and clear information on significant or unusual exclusions or limitations. A significant exclusion or limitation is one that would tend to affect the decision of consumers generally to buy. An unusual exclusion or limitation is one that is not normally found in comparable contracts. In determining what exclusions or limitations are significant, an insurer or intermediary should, in particular, consider the exclusions or limitations that relate to the significant features and benefits of a policy and factors which may have an adverse effect on the benefit payable under it. Examples of significant or unusual exclusions or limitations may include:
  - deferred payment periods;
  - exclusion of certain conditions, diseases or pre-existing medical conditions;
  - moratorium periods;
  - limits on the amounts of cover;
  - limits on the period for which benefits will be paid;
  - restrictions on eligibility to claim such as age, residence or employment; and
  - excesses.

19.7.13 Where a policy is bought in connection with other goods or services, the premium should be disclosed separately from any other prices. It should be made clear whether buying the policy is compulsory and, if so, whether it can be purchased elsewhere.

19.7.14 For investment-based insurance products, information on investment performance is generally provided. Where this includes an indication of past, simulated or future performance, the information should include any limits on upside or downside potential and a prominent warning that past performance is not a reliable indicator of future performance.

19.7.15 A helpful means to ensure that accurate and comprehensible information is provided to the customer is a product information sheet containing information on key product features that are of particular significance to the conclusion or performance of the insurance contract. The product information sheet should be clearly identified as such and it should be pointed out to the customer that the information is not exhaustive. Insofar as the information concerns the content of the contract, reference should be made as appropriate to the relevant provisions of the contract or to the general policy conditions underlying

the contract. Insurers, and intermediaries where they are involved, should consider the use of evaluation by third parties, such as consumer testing, in developing product information sheets in order to ensure their understandability.

Disclosure of rights and obligations

19.7.16 Retail customers, in particular, often have only limited knowledge about the legal rights and obligations arising from an insurance contract. Before an insurance contract is concluded, the insurer or intermediary, should inform a retail customer on matters such as:

- General provisions – including applicable law governing the contract;
- Obligation to disclose material facts – including prominent and clear information on the obligation on the customer to disclose material facts truthfully. Ways of ensuring a customer knows what he or she must disclose include explaining the duty to disclose all circumstances material to a policy and what needs to be disclosed, and explaining the consequences of any failure to make such a disclosure. Alternatively, rather than an obligation of disclosure, the customer may be asked clear questions about any matter material to the insurer;
- Obligations to be complied with when a contract is concluded and during its lifetime, as well as the consequences of non-compliance;
- Obligation to monitor cover – including a statement, where relevant, that the customer may need to review and update the cover periodically to ensure it remains adequate;
- Right to cancel – including the existence, duration and conditions relating to the right to cancel. If there are any charges related to the early cancellation or switching of a policy, this should be prominently disclosed;
- Right to claim benefits – including conditions under which the policyholder can claim and the contact details to notify a claim;
- Obligations on the customer in the event of a claim;
- Right to complain – including the arrangements for handling policyholders' complaints, which might include an insurer's internal claims dispute mechanism or the existence of an independent dispute resolution mechanism.

19.7.17 Where applicable, the customer may also be provided with information on any policyholder protection scheme or compensation scheme in the case of an insurer not being able to meet its liabilities and any limitations on such a scheme.

19.7.18 If the insurance undertaking is a foreign insurer, the insurer or intermediary should be required to inform the customer, before any commitment is entered into, of details such as:

- the home authority responsible for the supervision of the insurer;
- the jurisdiction in which the head office or, where appropriate, the branch with which the contract is to be concluded is situated; and
- the relevant provisions for making complaints or independent dispute resolution arrangements.

Disclosure specific to internet sales or sales through other digital means

19.7.19 Insurers and intermediaries are increasingly using digital distribution channels to market and sell insurance products, including internet and mobile phone solutions

19.7.20 It may be more difficult for consumers to understand from which location the insurer or intermediary is operating, their identity, and by whom and where they are licensed. This may especially be the case where more than one insurer or intermediary is involved in the distribution chain.

19.7.21 In conducting insurance business through digital channels, insurers and intermediaries should take into account the specificities of the medium used, and use appropriate tools to ensure that customers receive timely, clear and adequate information that helps their understanding of the terms on which the business is conducted.

19.7.22 The supervisors should require that insurers and intermediaries which offer insurance products through digital means disclose relevant business and contact information (eg on their website), such as:

- the address of the insurer's head office and the contact details of the supervisor responsible for the supervision of the head office;
- contact details of the insurer, branch or intermediary, and of the supervisor responsible for the supervision of the business, if different from the above;
- the jurisdictions in which the insurer or intermediary is legally permitted to provide insurance;
- procedures for the submission of claims and a description of the claims handling procedures; and
- contact information on the authority or organisation dealing with dispute resolution and/or consumer complaints.

19.7.23 The supervisor should apply to digital insurance activities requirements on transparency and disclosure so as to provide an equivalent level of protection to customers as those applied to insurance business conducted through non-digital means.

19.8 Where customers receive advice before concluding an insurance contract the supervisor requires that the advice provided by insurers and intermediaries takes into account the customer's disclosed circumstances.

19.8.1 Advice goes beyond the provision of product information and relates specifically to the provision of a personalised recommendation on a product in relation to the disclosed needs of the customer.

19.8.2 The insurer or the intermediary should make it clear to the customer whether advice is provided or not.

19.8.3 Insurers and intermediaries should seek the information from their customers that is appropriate for assessing their insurance demands and needs, before giving advice. This information may differ depending on the type of product and may, for example, include information on the customer's:

- financial knowledge and experience;
- needs, priorities and circumstances;
- ability to afford the product; and
- risk profile.

19.8.4 The supervisor may wish to specify particular types of policies or customers for which advice is not required to be given. Typically, this may include simple to understand products, products sold to customer groups that have expert knowledge of the type of product or, where relevant, mandated coverage for which there are no options. Even if no advice is given the supervisor may require the insurer or intermediary to take into account the nature of the product and the customer's disclosed circumstances and demands and needs.

19.8.5 In cases where advice would normally be expected, such as complex or investment-related products, and the customer chooses not to receive advice, it is advisable that the insurer or intermediary retains an acknowledgment by the customer to this effect.

19.8.6 The basis on which a recommendation is made should be explained and documented, particularly in the case of complex products and products with an investment element. All advice should be communicated in a clear and accurate manner, comprehensible to the customer. Where advice is provided, this should be communicated to the customer in written format, on paper or in a durable and accessible medium, and a record kept in a "client file".

19.8.7 The insurer or intermediary should retain sufficient documentation to demonstrate that the advice provided was appropriate, taking into account the customer's disclosed circumstances.

19.8.8 In addition, insurers and intermediaries should review the "client files" of those under their responsibility to exercise control after the fact on the quality of the advice given, take any necessary remedial measures with respect to the delivery of advice and, if applicable, be in a position to examine fairly any complaints submitted to it.

19.8.9 There should be a responsibility on the insurer and the intermediary to promote quality advice. In order to ensure the delivery of quality advice, the insurer and intermediary should, in particular, establish continuous training programmes that allow the persons giving advice to:

- keep abreast of market trends, economic conditions, innovations and modifications made to the products and services;
- maintain an appropriate level of knowledge about their industry segment, including the characteristics and risks of the products and services;
- know the applicable legal and regulatory requirements;
- know the requirements for the communication of information regarding the products and services and for appropriate disclosure of any situation liable to compromise the impartiality of the advice given or limit such advice; and
- be familiar with the documentation regarding the products and services and answer reasonably foreseeable questions.

This could include insurers providing training to their sales staff and to intermediaries in respect of specific products.

Policy servicing

19.9 The supervisor requires insurers to:

- **service policies appropriately through to the point at which all obligations under the policy have been satisfied;**
- **disclose to the policyholder information on any contractual changes during the life of the contract; and**
- **disclose to the policyholder further relevant information depending on the type of insurance product.**

19.9.1 For the purposes of this standard, "policyholder" refers only to the party to whom a contract of insurance is issued by an insurer (as opposed to the broader IAIS definition).

19.9.2 Supervisors should require insurers to satisfy obligations under a policy in an appropriate manner and in accordance with the contractually agreed terms and legal provisions. This should include fair treatment in the case of switching between products or early cancellation of a policy. To enable them to do so, insurers should maintain a relationship with the customer throughout the policy lifecycle.

19.9.3 Although ongoing policy servicing is traditionally seen as primarily the responsibility of the insurer, intermediaries are often involved, particularly where there is an ongoing relationship between the customer and the intermediary. The insurer should remain ultimately responsible for servicing policies throughout their life-cycle, and ensuring that intermediaries have appropriate policies and procedures in place in respect of the policy servicing activities that they perform on the insurer's behalf.

19.9.4 Policy servicing includes the provision of relevant information to customers throughout the life of the policy.

Information on the insurer

19.9.5 Information to be disclosed by the insurer to the policyholder includes:

- any change in the name of the insurer, its legal form or the address of its head office and any other offices as appropriate;
- any acquisition by another undertaking resulting in organisational changes as far as the policyholder is concerned; and
- where applicable, information on a portfolio transfer (including policyholders' rights in this regard).

Information on terms and conditions

19.9.6 Insurers should provide evidence of cover (including policy inclusions and exclusions) promptly after inception of a policy.

19.9.7 Information to be provided on an ongoing basis, including changes in policy terms and conditions or amendments to the legislation applicable to the policy, will vary by type of policy and may cover for example:

- main features of the insurance benefits, in particular details on the nature, scope and due-dates of benefits payable by the insurer;
- the total cost of the policy, expressed appropriately for the type of policy, including all taxes and other cost components; premiums should be stated individually if the insurance relationship comprises several independent insurance contracts or, if the exact cost cannot be provided, information provided on its basis of calculation to enable the policyholder to verify the cost;
- any changes to the cost structure, if applicable, stating the total amount payable and any possible additional taxes, fees and costs not levied via or charged by the insurer, as well as any costs incurred by the policyholder for the use of communication methods if such additional costs are chargeable;
- duration of the contract, terms and conditions for (early) termination of the contract and contractual consequences;
- means of payment of premiums and duration of payments;
- premiums for each benefit, both main benefits and supplementary benefits;
- information to the policyholder about the need to report depreciation/appreciation;
- information to the policyholder about other unique circumstances related to the contract;
- information on the impact of a switch option of an insurance contract;
- information on a renewal of the contract; and

- information on the ongoing suitability of the product, if such a service is provided by the insurer or intermediary.

19.9.8 Additional information provided to the policyholder regarding products with an investment element should at a minimum include:

- participation rights in surplus funds;
- the basis of calculation and state of bonuses;
- the current surrender value;
- premiums paid to date; and
- for unit-linked life insurance, a report from the investment firm (including performance of underlying funds, changes of investments, investment strategy, number and value of the units and movements during the past year, administration fees, taxes, charges and current status of the account of the contract).

19.9.9 Where there are changes in terms and conditions, the insurer should notify the policyholder of their rights and obligations regarding such changes and obtain the policyholder's consent as appropriate.

19.10 The supervisor requires insurers to handle claims in a timely, fair and transparent manner.

19.10.1 Supervisors should require that insurers have fair and transparent claims handling and claims dispute resolution policies and procedures in place.

Claims handling

19.10.2 Insurers should maintain written documentation on their claims handling procedures, which include all steps from the claim being raised to its settlement. Such documentation may include expected timeframes for these steps, which might be extended in exceptional cases.

19.10.3 Claimants should be informed about procedures, formalities and common timeframes for claims settlement.

19.10.4 Claimants should be given information about the status of their claim in a timely and fair manner.

19.10.5 Claim-determinative factors such as depreciations, discounting or negligence should be illustrated and explained in comprehensive language to claimants. The same applies where claims are denied in whole or in part.

19.10.6 Sometimes intermediaries serve as an initial contact for claimants, which may be in the common interest of the policyholder, intermediary and insurer.

19.10.7 A fair claims assessment process requires avoidance of conflicts of interest, as well as appropriate competence and ongoing training of the staff involved.

19.10.8 Competence requirements for claims assessment differ depending on the type of insurance policy and generally include technical and legal expertise.

Claims disputes

19.10.9 In the course of claims settlement, a dispute may arise between the claimant and the insurer on the claims settlement amount, or coverage. Staff handling claims disputes should be experienced in claims handling and be appropriately qualified.

19.10.10 Dispute resolution procedures should follow a balanced and impartial approach, bearing in mind the legitimate interests of all parties involved. Procedures should avoid being overly complicated, such as having burdensome paperwork requirements. Decisions should include the reasoning in clear language relating closely to the specific disputable issues.

19.10.11 Supervisors may encourage insurers to have mechanisms in place to review claims disputes within the insurer to promote fair play and objectivity in the decisions.

Outsourcing

19.10.12 If any of the claims handling processes are outsourced in part or in full, then supervisors should require insurers to maintain close oversight and ultimate responsibility for the provision of fair and transparent claims handling and claims dispute resolution.

19.11 The supervisor requires insurers and intermediaries to handle complaints in a timely and fair manner.

19.11.1 A complaint can be defined as an expression of dissatisfaction about the service or product provided by an insurer or intermediary. It may involve, but should be differentiated from, a claim and does not include a pure request for information.

19.11.2 Insurers and intermediaries should establish policies and procedures to deal in a fair manner with complaints which they receive. These should include keeping a record of each complaint and the measures taken for its resolution.

19.11.3 Insurers and intermediaries should make information on their policies and procedures on complaints handling available to customers.

19.11.4 Insurers and intermediaries should respond to complaints without unnecessary delay; complainants should be kept informed about the handling of their complaints.

19.11.5 Insurers and intermediaries should analyse the complaints they receive to identify trends and recurring risks. Analysis of what leads to individual complaints can help them to identify, and enable them to correct, common root causes.

19.11.6 Insurers should analyse complaints that they receive against intermediaries in respect of products that the intermediaries have distributed on their behalf, to enable them to assess the complete

customer experience and identify any issues that need to be addressed.

19.11.7 Supervisors may choose to have their own complaints monitoring systems in place in order to benefit from the findings resulting from policyholder complaints.

19.11.8 Some insurers and intermediaries may decide to establish a mechanism to review complaints, in order to ensure respective policies on complaint handling are in place.

Independent dispute resolution mechanisms

19.11.9 It is important that there are simple, affordable, easily accessible and equitable mechanisms in place, independent of insurers and intermediaries, to resolve disputes that have not been resolved by the insurer or intermediary. Such mechanisms, collectively referred to here as Independent Dispute Resolution ("IDR") mechanisms, may vary across jurisdictions and may include mediation, an independent review organisation, or an ombudsman. These are out of court mechanisms.

19.11.10 IDR mechanisms often operate on the basis of a code of procedure, or in some cases legislative rules, and may be restricted to retail policyholders. They are sometimes free of charge for such policyholders. Decisions are generally non-binding for the policyholder but may be binding for the insurer or intermediary within certain limits. As consumers may still avail themselves of court processes if the dispute is not satisfactorily resolved, it is usually agreed that the period of limitation is suspended during an IDR procedure.

19.11.11 Mediators serving IDR mechanisms should meet high standards of professional knowledge, integrity and competence. This would be evidenced, for example, where the mediator is qualified to exercise the functions of a judge and is well grounded in the field of insurance law. Although IDR mechanisms are usually financed by insurers and/or intermediaries, their mediators must be independent from them. Doubts over independence might be expected if the mediator:

- is subject to instructions from insurers/intermediaries;
- is a former employee of an insurer/intermediary; or
- simultaneously performs other functions which could affect their independence.

19.12 The supervisor requires insurers and intermediaries to have policies and procedures for the protection and use of information on customers.

19.12.1 Insurers and intermediaries collect, hold, use or communicate to third parties information on their customers in the course of their business. It is important that they have in place policies and procedures on the appropriate use and, in the case of personal information, the privacy of such data.

Protecting the privacy of personal information

19.12.2 Significant amounts of the information collected, held or processed represent customers' financial, medical and other personal information.

Security over such information is extremely important, regardless of the format of the information (eg whether physical or electronic). Hence safeguarding personal information on customers is one of the key responsibilities of the financial services industry.

19.12.3 Legislation identifies the provisions relating to privacy protection under which insurers and intermediaries are allowed to collect, hold, use or communicate personal information on customers to third parties. Generally, the legislation also identifies who is the competent authority.

19.12.4 Although data protection laws vary from jurisdiction to jurisdiction, insurers and intermediaries should have a clear responsibility to provide their customers with a level of comfort regarding the security of their personal information.

19.12.5 In view of the sensitivity of private information and the risks to consumers and to the insurance sector in the event of failures to protect the privacy of such information, the supervisor should be satisfied that insurers and intermediaries have sufficient safeguards in place to protect the privacy of personal information on customers. To achieve this the supervisor should require insurers and intermediaries to have appropriate policies and procedures in place. Such policies and procedures should seek to embed the importance of protecting the privacy of personal information within the organisation, as well as provide appropriate management of the risks. Examples of areas that might be covered include:

- ensuring that the Board and Senior Management are aware of the challenges relating to protecting the privacy of personal information on customers;
- demonstrating that privacy protection is part of the organisation's culture and strategy, through measures such as training to employees that promotes awareness of internal and external requirements on this subject;
- implementing policies, procedures and internal control mechanisms that support the objectives of protecting the privacy of personal information on customers and assess the risks associated with potential failure to protect the privacy of personal information;
- assessing the potential impact of new and emerging risks that could threaten the privacy of personal information, such as the risk of cyber attacks, and taking appropriate steps to mitigate these through measures such as internal controls, technology and training; and
- determining the response measures that may be needed where a failure to protect the privacy of personal information occurs, including matters such as timely notification to affected customers and competent authorities.

In assessing policies and procedures to protect the privacy of personal information on customers, depending on the jurisdiction, the insurance supervisor may need to liaise with the relevant competent authority.

Protection against the misuse of customer information

19.12.6 Insurers and intermediaries use personal and other information on customers for a variety of purposes within the course of business that include, amongst other things, product development, marketing, product pricing, and claims management.

19.12.7 The supervisor should not allow insurers and intermediaries to use customer information that they collect and hold in a manner that results in unfair treatment. Insurers and intermediaries should have appropriate policies and procedures in place. The measures that the supervisor should expect such policies and procedures to cover may include:

- ensuring that the appropriate technology is available and in place to manage adequately the personal and other information an insurer or intermediary is holding on a customer;
- implementing policies and procedures relating to the use of data, ensuring that the data collected is not used in an unfair manner including when processed through algorithms or other technologies;
- ensuring that such policies and procedures provide that customer data will not be abused to circumvent rules on prohibitions on aggressive marketing practices or discrimination;
- ensuring that customers have a right to access and, if needed, to correct data collected and used by insurers and intermediaries; and
- ensuring that group structures are not abused to circumvent prohibitions on the sharing of personal information.

In assessing policies and procedures to prevent the use of customer information in a manner that results in unfair treatment, depending on the jurisdiction, the insurance supervisor may need to liaise with the relevant competent authority.

Outsourcing

19.12.8 Insurers and intermediaries should be aware of outsourcing risk, especially when the outsourcing agreement is reached with firms in another jurisdiction. Insurers and intermediaries should ensure that the firms to which they outsource processes have adequate policies and procedures in place for the protection and use of private information on customers they have in their records.

Data access in the event of reorganisation

19.12.9 All the necessary data required in the event of restructuring, resolution and liquidation should, subject to data protection requirements, be accessible and readable at the insurer's or intermediary's domicile at any time. This includes all customer-related data, such as claims and policy data.

Information supporting fair treatment

19.13 The supervisor publicly discloses information that supports the fair treatment of customers.

19.13.1 The supervisor should publish the policyholder protection arrangements that are in place for insurance contracts sold within its jurisdiction and insurers subject to its supervision, and confirm the position of policyholders dealing with insurers and intermediaries not subject to oversight or supervision within its jurisdiction.

19.13.2 The supervisor should give information to the public about whether and how local legislation applies to the cross-border offering of insurance, such as through digital channels.

19.13.3 The supervisor should issue warning notices to consumers when necessary in order to avoid transactions with insurers or intermediaries that are unlicensed or subject to a suspended or revoked licence.

19.13.4 The supervisor should publish information that promotes consumers' understanding of insurance contracts as well as steps that consumers can take to protect themselves and make informed decisions.

19.13.5 The supervisor should have requirements regarding the public disclosure by insurers of information on their business activities, performance and financial position, in order to enhance market discipline, consumer awareness, and understanding of the risks to which insurers are exposed (see ICP 20 Public Disclosure).

ICP 20 Public Disclosure

The supervisor requires insurers to disclose relevant, comprehensive and adequate information on a timely basis in order to give policyholders and market participants a clear view of their business activities, performance and financial position. This is expected to enhance market discipline and understanding of the risks to which an insurer is exposed and the manner in which those risks are managed.

Introductory Guidance

20.0.1 It is important to improve and maintain the quality, timeliness and relevance of disclosure of key information needed for credit and investment decisions as well as policyholder's decisions.

20.0.2 Whereas accounting standards (including IFRS/IAS and local generally accepted accounting standards) set out disclosure requirements for general purpose financial reporting across sectors, this ICP is only concerned with insurers. So far as practicable, information should be presented in accordance with any applicable generally accepted national and international standards and practices so as to aid comparisons between insurers.

20.0.3 In setting public disclosure requirements supervisors should take into account the information provided in general purpose financial statements and complement it as appropriate. Adequate public disclosure supports the supervisory process. Supervisors should ensure market discipline is achieved through disclosure and that the relevant market participants have adequate information available to assess the performance of and risks taken by insurers and to respond appropriately.

20.0.4 The nature, scale and complexity of insurers is important for the application of disclosures and applies to these standards. Where it is not reasonable for some entities in some markets to provide information precisely in accordance with these standards, the supervisor can ensure that the intent of the standards is met to ensure market discipline is achieved through disclosure and that the relevant market participants have adequate information available for their needs.

20.0.5 So that public disclosure is meaningful to market participants, it may usefully include an adequate description of how information is prepared, including methods applied and assumptions used. Such disclosure of methods and assumptions also assists market participants to make comparisons between insurers. Accounting and actuarial policies, practices and procedures differ not only between jurisdictions but also between insurers within the same jurisdiction. Meaningful comparisons can thus only be made where there is adequate disclosure of how information is prepared.

20.0.6 Similarly meaningful comparisons from one reporting period to another can only be made if the reader is informed how the methods and assumptions of preparation have changed and, if practicable, the impact of that change. Changes over time will not be seen as arbitrary if the reasons for changes in methods and assumptions are explained. If an

insurer uses methods and assumptions in the preparation of information which are consistent from period to period and discloses these it would assist in the identification of trends over time.

20.0.7 Where changes in methods and assumptions are made, the nature of such changes, the reason for them and their effects, where material, should be disclosed. It is appropriate if information is presented so as to facilitate the identification of patterns of development over time including providing comparative or corresponding figures from previous periods (e.g. by presenting loss triangulations).

20.0.8 Information is decision useful if there is a substantial likelihood that a market participant would consider it important in making a key decision. Typically, the key decisions are whether to insure risks with, invest in or effect other transactions with an insurer.

20.0.9 Excessive disclosure requirements will not lead to effective disclosures for market participants but will be burdensome for insurers. In developing disclosure requirements within a jurisdiction, supervisors should consider the need for disclosures to deliver key information rather than significant volumes of data.

20.0.10 All insurers, whether or not they are required to report under accounting standards, must comply with the requirements of this ICP. Insurers that are entities that provide public general purpose financial reports ("reporting entities") may largely comply with the standards through these reports. To the extent that financial reporting standards, including generally accepted national or international standards, are consistent with the standards in this ICP, disclosures that are in accordance with those financial reporting standards may be regarded as compliant with this ICP.

20.0.11 Supervisors can decide not to apply these standards to captives, provided there is no potential threat to the financial system, no public interest need for disclosure and no legitimately interested party is prevented from receiving information.

20.0.12 ICP 9 Supervisory Review and Reporting deals with reporting to supervisors. In some jurisdictions, reporting to supervisors is made public by supervisors or at least some aspects of that reporting to supervisors is made public. To demonstrate observance with the standards in this ICP, disclosure can be made by supervisors rather than direct disclosure by insurers. There may be some overlap in the standards set out in ICP 9 and the standards set out in this ICP. ICP 9 and this ICP have very different purposes. ICP 9 covers requirements for reporting to supervisors in order for supervisors to be able to exercise their functions. Where requirements for reporting to supervisors and for public disclosure overlap, supervisors should consider the most efficient way of using publicly disclosed information.

20.0.13 The IAIS considers it is most desirable that the methodologies for calculating items for public disclosure can be used for, or are substantially consistent with, the methodologies used for regulatory reporting purposes, with as few changes as possible to satisfy regulatory requirements. However, the IAIS also recognises that this may not be possible or appropriate in all respects, considering the differing purposes.

To the extent that there are differences, the IAIS believes it is essential that they are publicly explained and reconciled.

20.0.14 There may be differences in the composition of a group in general purpose financial reporting because a consolidated group as determined under applicable accounting standards might differ from a group for the purposes of insurance supervision (see ICP 23 Group-wide Supervision). In certain circumstances where this is the case, the insurer could endeavour to provide disclosures based on the scope of the group for supervisory purposes to the extent practicable. Where a group has been unable to disclose information based on the scope of the group for supervisory purposes, it would be appropriate if reasons are provided and an explanation given about the basis on which disclosures have been provided and potential differences to the position for group-wide supervisory purposes. It is essential to the understanding of market participants that analysis of differences between consolidated general purpose financial reporting and consolidated reporting for solvency purposes based on the scope of a group determined under ICP 23 is provided. Insurance legal entity disclosures are also vital in understanding the group from a supervisory perspective.

20.0.15 This ICP applies to both groups and solo legal entities to the extent that is useful and practical. Policyholders will be concerned with information about both the group and the individual insurance legal entity within the group offering the product to the policyholder. A policyholder's information needs are also covered in ICP 19 Conduct of Business. Other market participants such as investors and lenders will be interested in the legal structure in which they have an interest which is often the group level.

20.0.16 Where a group conducts activities at a group level that are applicable to insurance legal entities, the disclosure of these activities should only occur at group level. Disclosures by the insurance legal entities can cross-refer to these group level disclosures for completeness.

20.0.17 In applying the standards under this ICP in its jurisdiction, a supervisor must balance the information needs of the range of market participants also taking into account the concerns about excessive disclosures raised in Guidance 20.0.9. In some circumstances it may be possible for the needs of most market participants to be met with group level disclosures with some additional insurance legal entity disclosures specifically for policyholders.

20.0.18 All standards under this ICP are applicable to both non-life and life insurers. Some paragraphs of guidance are more applicable to either non-life or life insurers.

20.0.19 Proprietary information comprises information on characteristics and details of, for example, (insurance) products, markets, distribution and internal models and systems that would negatively influence the competitive position of an insurer if made available to competitors. Information about policyholders and insured parties is usually confidential on the basis of privacy legislation or contractual arrangements with the policyholder.

20.0.20 This affects the scope of the required disclosure of information by insurers about their customer base and details on internal arrangements, for instance methodologies used, parameter estimates data etc. The IAIS believes that the requirements set out in this ICP strike an appropriate balance between the need for meaningful disclosure and the protection of proprietary and confidential information. In the case that disclosure of certain items of information required by this ICP should seriously prejudice the position of the insurer by making public information that is either proprietary or confidential in nature, an insurer need not disclose those specific items, but should disclose more general information about the subject matter of the requirement.

20.1 Insurers disclose, at least annually, appropriately detailed quantitative and qualitative information in a way that is accessible to market participants on their profile, governance and controls, financial position, technical performance and the risks to which they are subject. In particular, information disclosed must be:

- **decision useful to decisions taken by market participants;**
- **timely so as to be available and up-to-date at the time those decisions are made;**
- **comprehensive and meaningful;**
- **reliable as a basis upon which to make decisions;**
- **comparable between different insurers operating in the same market; and**
- **consistent over time so as to enable relevant trends to be discerned.**

20.1.1 Disclosures should be presented in a manner that is appropriate to the nature of the information disclosed and that takes into account items that comprise the insurer's financial position. Key accounting methodologies and assumptions used in preparing the information should be clearly explained.

20.1.2 Information should be disseminated in ways best designed to bring it to the attention of market participants, but taking into account the relative costs of different methods of dissemination. One method of dissemination that supervisors could strongly encourage is disclosure through electronic channels (e.g. internet).

20.1.3 Information should be provided with sufficient frequency and timeliness to give a meaningful picture of the insurer.

20.1.4 The requirement for timeliness needs to be balanced against that for reliability. Disclosure of information may be delayed for a short period to allow for proper verification, but only where such delay would not significantly disadvantage users.

20.1.5 Information needs to be sufficiently comprehensive to enable market participants to form a well-rounded view of an insurer's financial condition and performance, business activities, and the risks related to those activities. In order to achieve this, it is expected that information be:

- sufficiently well-explained so that it is meaningful to a reader who is well-informed as to the inherent nature of insurance

business but has no particular knowledge of the insurer except as derived from public disclosures

- complete so that it covers all material circumstances of an insurer and, where relevant, those of the group of which it is a member
- both appropriately aggregated so that a proper overall picture of the insurer is presented and sufficiently disaggregated so that the effect of distinct material items may be separately identified.

20.1.6 Information should faithfully represent the facts which it purports to represent, or could reasonably be expected to represent. In particular, it needs to, so far as practicable, reflect the economic substance of events and transactions as well as their legal form. Where the economic substance of an event or transaction is inconsistent with its legal form, the former is expected to prevail. The information should be verifiable, neutral (that is free from material error or bias) and complete in all material respects. Completeness is important since an omission can cause information to be false or misleading.

20.1.7 In many instances, insurers may have to balance the interests of reliability against those of decision usefulness and timeliness. For example, in some long-tail classes of insurance, realistic projections as to the ultimate cost of incurred claims are highly relevant. However, due to uncertainties, such projections are subject to inherent errors of estimation. Qualitative or quantitative information can be used to convey to users an understanding of the relevance and reliability of the information disclosed.

20.1.8 To aid comparison, it is important therefore that the methods and assumptions used in preparing the information are themselves adequately disclosed. This might include an insurer's rationale for applying particular accounting policy choices where such a choice exists in the standards. While this will assist users in interpreting publicly disclosed information, it is recognised that international standards need to be developed and adopted uniformly for true comparability to be achieved.

20.1.9 It would be usual if disclosures were to include a quantitative analysis of the insurer's sensitivity to changes in key assumptions including, where material, the effect of derivatives and other forms of risk mitigation on that sensitivity.

20.2 Disclosure about the financial position of the insurer includes appropriately detailed quantitative and qualitative information about the determination of technical provisions. Technical provisions are presented by appropriate segment. This disclosure includes, where relevant to policyholders and market participants, information about the future cash flow assumptions, the rationale for the choice of discount rates, and risk adjustment methodology where used or other information as appropriate to provide a description of the method used to determine technical provisions.

20.2.1 Presentation of technical provisions and reinsurance assets on a gross basis is expected. However, it may be useful to present information about technical provisions on both a net and gross basis depending on typical

measures of performance and solvency that are applied by market participants.

20.2.2 The purpose of disclosures in respect of technical provisions is to provide market participants with an understanding of how those technical provisions are determined. As such, disclosures would be expected to include information about the amount, timing and uncertainty of future cash flows in respect of insurance obligations.

20.2.3 Information about the determination and adequacy of technical provisions may include the run-off result where applicable.

20.2.4 Absent exceptional circumstances, information should be disclosed about the method used to derive the assumptions for calculating the technical provisions including the relative weights placed on current experience and relevant past experience and allowances made for future changes. Information may also be disclosed about significant changes in assumptions.

20.2.5 Where the current estimate and margin over the current estimate are determined separately, the disclosures may include information about the methods used for each of these components of the technical provisions.

20.2.6 It is proposed that the insurer discloses the methodology by which risk is taken into account and the reasons why it is regarded as appropriate. If the methodology has changed since the last reporting period, it would be useful if the insurer discloses the reasons for the change.

20.2.7 It may be useful if the insurer provides an outline of any model or models used and describes how the range of scenarios regarding future experience has been derived.

20.2.8 A description of any method used to treat acquisition costs and whether future profits on existing business have been recognised would be useful.

20.2.9 It may be appropriate in some circumstances that the insurer discloses the surrender values payable.

20.2.10 Disclosure of a reconciliation of technical provisions from the end of the previous year to the end of the current year would be particularly useful.

20.2.11 It would be usual for technical provisions to be disclosed in two parts:

- One part that covers claims from insurance events which have already taken place at the date of reporting (claims provisions including IBNR provisions and IBNER provisions) and for which there is an actual or potential liability
- Another part that covers losses from insurance events which will take place in the future (the sum of provision for unearned premiums and provision for unexpired risks also termed premium deficiency reserve).

This split is particularly important for lines of insurance business for which claims may take many years to settle.

Life insurers

20.2.12 It may be useful if the insurer discloses key information on the assumed rates and the method of deriving future mortality and disability rates and whether customised tables are applied. The insurer should disclose significant assumptions about future changes of mortality and disability rates.

20.2.13 It may enhance understanding if the insurer discloses the conditions for the amount and timing of the allocation of participation features and how such features are valued in technical provisions. Disclosure could be made as to whether participation features are based on the performance of a group of contracts, on the realised/unrealised investment returns from a pool of assets, on the profit or loss of the company, or on any other element. Disclosure could also be made of the extent to which such features are contractual and/or discretionary.

20.2.14 It is suggested that the insurer discloses quantitative information on minimum participation features and actual distributions to policyholders.

20.2.15 For example, the following quantitative information can be shown by segment:

- guaranteed policyholder benefits paid
- additional policyholder benefits paid which arise from profit sharing clauses.

20.2.16 It may be useful if the insurer discloses the assumptions and methodologies employed to value significant guarantees and options, including the assumptions concerning policyholder behaviour.

Non-life insurers

20.2.17 In order to enable market participants to evaluate trends, non-life insurers could disclose historical data about earned premiums compared to technical provisions by class of business. To assess the appropriateness of assumptions and methodology used for determining technical provisions, non-life insurers could disclose historical data on:

- the run off result
- claims development.

20.2.18 To facilitate the evaluation of an insurer's ability to assess the size of the commitments to indemnify losses covered by the insurance contracts issued, it is suggested that insurers disclose historical data on the results of the run off of technical provisions set aside in previous accounts.

20.2.19 It is suggested that insurers provide information on the run off results defined below for each part of the technical provisions. The run off result in relation to provisions for incurred losses is the difference between:

- the claims provisions made at the beginning of the financial year, and
- the sum of the payments made during the year on account of claims incurred in previous years and the claims provisions shown at the end of the year for such outstanding claims.

The run off result in relation to provisions for future losses is the difference between:

- the sum of provision for unearned premiums and provision for unexpired risks made at the beginning of the year, and
- an evaluation of the payments made during the year and provisions made at the end of the year, in both cases relating to insurance events covered by the unearned premiums at the beginning of the year.

20.2.20 It may be useful if the run off results are disclosed as a ratio of the initial provisions for the losses in question. When discounting is used, the effect of discounting should be shown separately.

20.2.21 It is suggested that insurers disclose the run off results over several years to enable market participants to evaluate long-term patterns, for example, how well the insurer estimates the technical provisions. The length of the time period reflects how long-tailed the distribution of losses is for the insurance classes in question.

20.2.22 Except for short-tail business, insurers may disclose information on the development of claims in a claims development triangle (see Table 20.1 for an example). The claims development triangle shows the insurer's estimate of the cost of claims (claims provisions and claims paid) as of the end of each year and how this estimate develops over time. This information should be reported consistently on an accident year or underwriting year basis and reconcile to amounts reported in the balance sheet.

Table 20.1: Example: Claims development triangle

This example illustrates a possible format for a claims development triangle.

Accident year	1997	1998	1999	2000	2001	
Claims provisions and claims paid at the end of the accident year	680	790	823	920	968	
One year later	673	785	840	903		
Two years later	692	776	845			
Three years later	697	771				
Four years later	702					
						Total
Estimate of cumulative claims	702	771	845	903	968	
Cumulative payments	(650)	(689)	(570)	(350)	(217)	
Claims provisions (undiscounted)	52	82	275	553	751	1,713
Earned premiums	822	933	1,052	1,123	1,215	
When discounting is used:						
Effect of discounting	(5)	(14)	(68)	(175)	(285)	(547)
Present value recognised in the balance sheet	47	68	207	378	466	1,166

20.2.23 Figures used to assess the appropriateness of the assumptions and methodology used for determining technical provisions may usefully be calculated gross of reinsurance and be supported by an accompanying narrative.

20.3 Disclosure about the financial position of the insurer includes appropriately detailed quantitative and qualitative information about capital adequacy. An insurer discloses information that enables users to evaluate the insurer's objectives, policies and processes for managing capital and to assess its capital adequacy. This information encompasses the generic solvency requirements of the jurisdiction(s) in which the insurer operates and the capital available to cover regulatory capital requirements. If an internal model is used to determine capital resources and requirements, information about the model must be provided, having due regard to proprietary or confidential information.

20.3.1 Information about objectives, policies and processes for managing capital assist in promoting the understanding of risks and measures which influence the capital calculation and the risk tolerance that is applied.

20.3.2 It may be useful if the insurer discloses quantitative information to allow market participants to assess the quantity and quality of its capital in relation to regulatory capital requirements. In particular it may be useful if it sets out available capital in components and the amount of capital it holds in each component, referencing changes from previous periods.

20.3.3 It is suggested that the insurer discloses qualitative information about its management of capital regarding:

- regulatory capital requirements
- instruments regarded as available capital
- the policies and processes for managing capital
- key risks and measures which influence the capital calculation
- the insurer's risk tolerance policy.

20.3.4 In addition to the differences in the composition of a group for the purposes of general purpose financial reporting and supervision as outlined in Guidance 20.0.14, there may be a further difference in the composition of a group for the purposes of determining capital adequacy of a group (see ICP 17 Capital Adequacy). It may be useful if a description of the group as defined for capital adequacy purposes is given and any variation from the composition of the group for general purpose financial reporting purposes is explained.

20.4 Disclosure about the financial position of the insurer includes appropriately detailed quantitative and qualitative information about financial instruments and other investments by class. In addition, information disclosed about investments includes:

- **investment objectives;**
- **policies and processes;**
- **values, assumptions and methods used for general purpose financial reporting and solvency purposes, as well as an explanation of the differences (where applicable); and**
- **information concerning the level of sensitivity to market variables associated with disclosed amounts.**

20.4.1 Where investment management objectives, policies and processes differ between segments of the insurer's investment portfolio, disclosure should be sufficient to provide an understanding of those differences.

20.4.2 For the purposes of disclosure it may be appropriate if an insurer groups assets and liabilities with similar characteristics and/or risks into classes and then discloses sufficient information segregated by those classes.

20.4.3 When providing disclosures around the uncertainty of reported values of financial instruments and other investments, it may be useful if the effect of derivatives on that uncertainty is disclosed.

20.4.4 An insurer's asset portfolio generally consists of many types of instruments with a variety of characteristics. These instruments may differ in the manner in which they are valued, their expected returns, sensitivity to market variables, level of liquidity or constraints on disposal. To allow effective management and meaningful analysis of risks and performance, instruments exhibiting similar risk and return behaviour need to be grouped. The most common way is grouping them by type of asset class. However, for some jurisdictions, grouping by risk exposure might be appropriate. It is expected that in those jurisdictions more information will

need to be disclosed about the risk management techniques used to measure the economic effect of risk exposure. Such disclosure may in addition include an analysis by type of asset class.

20.4.5 Materiality considerations should be taken into account when setting up asset classes in accordance with the nature, scale and complexity of the insurer (see Guidance 20.0.4). Disclosure at an excessive level of segregation may overwhelm market participants and incur unnecessary costs for insurers. On the other hand, over-aggregation may conceal important information.

20.4.6 It may be appropriate if an insurer discloses sufficient information, including quantifiable information, about its exposure to:

- Currency risk
- Market risk (including interest rate risk)
- Credit risk
- Liquidity risk
- Concentration risk.

20.4.7 Generally, the return achieved may be disclosed together with the risk exposure and investment objective. Disclosure of risk exposures can provide market participants with valuable insight into both the level of variability in performance that one can expect when economic or market conditions change, and the ability of an insurer to achieve its desired investment outcome.

20.4.8 Guidance 20.4.6 lists key risks related to investment activities. It should be noted, however, that these risks may affect both assets and liabilities. Market risk arising from interest rate movement is an example. Where an insurer's liabilities for policies issued are valued using market interest rates, both asset and liability values change as interest rates move. Furthermore, changes in interest rates may also change the amounts that an insurer has to pay for its borrowings. Therefore, it is suggested that disclosure of risk exposure includes exposure arising from both an insurer's assets and its liabilities.

20.4.9 To facilitate the relevant disclosure of risk exposures, it may be appropriate if an insurer discloses the intra-period high, median and low exposures where there have been significant changes in exposure since the last reporting date. The amount bought and sold during a reporting period may be disclosed as a proxy for turnover. Such risk exposures may be disclosed for each asset class.

20.4.10 Appropriate disclosure of risk measures may usefully reflect the model used by the insurer in managing its market risk and where relevant, for example, include the results of sensitivity tests such as the percentage change in capital resources or the change in capital resources as a percentage of total assets corresponding to a 100 basis point change in interest rates. Such sensitivity measures may also be extended to equity price, property price or foreign currency sensitivity.

20.4.11 For debt securities, information concerning the sensitivity of values to market variables including credit spreads may include breakdowns by

credit rating of issue, type of issuer (e.g. government, corporate) and by period to maturity (see Table 20.2 for example).

20.4.12 On the disclosure of credit risk, in addition to breakdowns on ratings and types of credit issuers described in Guidance 20.4.11, it is recommended that an insurer discloses the aggregate credit risk arising from off-balance sheet exposures.

Table 20.2: Example: Information regarding debt securities								
	Economic value				Historical costs			
	This year		Last year		This year		Last year	
	Amount	As % of total for this class	Amount	As % of total for this class	Amount	As % of total for this class	Amount	As % of total for this class
Breakdown by credit rating								
AA- or better								
Worse than AA- but not worse than A-								
Worse than A- but not worse than BBB-								
Worse than BBB- but not worse than B-								
Worse than B-								
Unrated								
Breakdown by residual maturity								
Up to 1 year								
More than 1 year and up to 3 years								
More than 3 years and up to 7 years								
More than 7 years and up to 10 years								
More than 10 years								

Breakdown by type of issuer								
Government								
Semi-government[77]								
Corporate securities								

20.5 Disclosure about the financial position of the insurer includes appropriately detailed quantitative and qualitative information about enterprise risk management (ERM) including asset-liability management (ALM) in total and, where appropriate, at a segmented level. At a minimum, this information includes the methodology used and the key assumptions employed in measuring assets and liabilities for ALM purposes and any capital and/or provisions held as a consequence of a mismatch between assets and liabilities.

20.5.1 Where derivatives are used, it may be useful that the disclosures include a description of both the nature and effect of their use.

20.5.2 Asset-liability management is of paramount importance to insurers. An unmatched position may increase the risk of loss but can enhance profitability.

20.5.3 It may be appropriate if insurers disclose how they approach asset-liability management. To achieve this, an insurer could disclose qualitative information explaining the appropriateness of its management of assets and liabilities and how it is co-ordinated. The explanation could take into account the ability to realise its investments quickly, if necessary, without substantial loss, and sensitivities to fluctuations in key market variables (including interest rate, exchange rate, and equity price indices) and credit risks.

20.5.4 Where the insurer's ALM is segmented, e.g. by different lines of business, the insurer may disclose information on asset-liability management (ALM) at a segmented level.

20.5.5 It may be appropriate if the insurer discloses the sensitivity of regulatory capital resources and provisions for mismatching to:

- changes in the value of assets
- changes in the discount rate or rates used to calculate the value of the liabilities.

20.6 Disclosure includes appropriately detailed quantitative and qualitative information on financial performance in total and by segmented financial performance. Where relevant, disclosures must include a quantitative source of earnings analysis, claims statistics including claims development, pricing adequacy, information on returns on investment assets and components of such returns.

[77] Include debt securities issued by statutory bodies or municipalities.

General financial performance

20.6.1 The insurer may provide a statement of changes in equity showing gains and losses recognized directly in equity as well as capital transactions with and distributions to shareholders, and profit-sharing with policyholders.

20.6.2 The insurer may disclose information on its operating segments. For each segment, the factors used to identify the reportable segments have to be disclosed, e.g. the number of contracts or of policyholders.

20.6.3 An operating segment is a component of an entity that engages in business activities from which it may earn revenues and incur expenses and whose operating results are regularly reviewed by the entity's management to make decisions about resources to be allocated to the segment. Examples of features by which business is segmented are:

- Type of business: life insurance, non-life insurance, investment management
- Mix of organisational and geographic approach: e.g. Insurance Country X, Insurance Country Y, Insurance (other), asset management Country Z.

20.6.4 These standards do not intend to prescribe a specific format for the disclosure of segments and the disclosure of portfolios. Jurisdictions may develop a format as well as the threshold of disclosure which is applicable to the insurance industry.[78]

Technical performance

20.6.5 The insurer may be expected to provide statements of profit and loss (including the technical underwriting account gross and net of reinsurance by broad lines of business).

20.6.6 If the insurer is a cedant, it may disclose gains and losses recognised in profit or loss on buying reinsurance.

20.6.7 It may be appropriate if an insurer provides qualitative and quantitative information on technical performance in the areas of pricing adequacy, appropriateness of technical provisions, claims statistics, risk concentrations, reinsurance and capital and their interaction. Note that the analysis of past performance is a major foundation on which the assessment of future risks is based.

Technical performance for non-life insurers

[78] Under IFRS generally a segment should represent at least 10% of total external revenue to be reportable. However, if after determining the reportable segments, the entity should ensure that the total external revenue attributable to those reportable segments is at least 75% of the entity's total revenue. When the 75% threshold is not met, additional reportable segments should be identified (even if they do not meet the 10% thresholds), until at least 75% of the entity's total external revenue is included in its reportable segments.

20.6.8 In order to judge how well insurance premiums cover the underlying risk of the insurance contracts and the administration expenses of the insurer (pricing adequacy), an insurer may disclose data on:

- loss ratio
- expense ratio
- combined ratio
- operating ratio.

20.6.9 These ratios should be calculated from the profit and loss account of the reporting year and be gross of reinsurance in order to neutralize the effect of mitigation tools on the technical performance of the direct business. Gains on reinsurance cannot be expected to continue indefinitely without price adjustments from reinsurers. Disclosure on reinsurance is described in Guidance 20.7.2. If the net ratios are materially different from the gross ratios, then both ratios should be disclosed. The ratios should be measured either on an accident year or an underwriting year basis.

20.6.10 When discounting is used, information on the discount rates used and method of discounting may be provided. The discount rates should be disclosed at an appropriate level of aggregation by duration for example:

- for each of the next five years
- average rate for claims expected to be paid after five years.

20.6.11 The disclosure in Guidance 20.6.10 should be accompanied by supporting narrative, over several years as appropriate, to enable market participants to better evaluate long term trends. Information relating to previous years should not be recalculated to take into account present information. The length of the time period may reflect the historical volatility of the particular class of insurance business.

20.6.12 It may be appropriate in the case of high volume, homogeneous classes, for direct insurers to disclose statistical information on claims. For instance, they could describe the trend in the number of claims and the average size of claims. To be relevant, this information needs to be linked to the level of business (e.g. number of policies, earned premiums, etc.).

20.6.13 In principle, the trend in claims may reflect the development in insurance risks. As it is difficult to point to one good measurement method of insurance risk, several can be considered but, at a minimum, it would be normal for insurers to disclose historical data accompanied by supporting narrative on:

- the mean cost of claims incurred – i.e., the ratio of the total cost of claims incurred to the number of claims – in the accounting period by class of business
- claims frequency - for example, the ratio of the number of claims incurred in the reporting period to the average number of insurance contracts in existence during the period.

20.6.14 For non-homogeneous classes, qualitative information will suffice.

Source of earnings analysis for life insurers

20.6.15 It may be useful if life insurers disclose expected earnings on in-force business. This represents the earnings on the in-force business that were expected to be realised during the reporting period based on achieving the assumptions used to calculate the technical provisions. Examples of this include expected release of risk margins, net management fees, and earnings on deposits.

20.6.16 Life insurers may be expected to disclose the impact of new business. This represents the point-of-sale impact on net income of writing new business during the reporting period. This is the difference between the premium received and the sum of the expenses incurred as a result of the sale and the new technical provisions established at the point of sale. This item is also affected by any methodology used to defer and amortise acquisition expenses.

20.6.17 It may be useful if life insurers disclose experience gains and losses. This represents gains and losses that are due to differences between the actual experience during the reporting period and the technical provisions at the start of the year, based on the assumptions at that date.

20.6.18 Life insurers may be expected to disclose the impact on earnings of management actions and changes in assumptions.

20.6.19 An example source of earnings analysis for a life insurer is provided in Table 20.3 below.

Table 20.3: Example: Source of Earnings

	Segment A		**Segment B**		**Total**	
	Current Year	**Previous Year**	**Current Year**	**Previous Year**	**Current Year**	**Previous Year**
Expected earnings on in-force business						
Impact of new business						
Experienced gains and losses:						
Investment						
Mortality						
Expenses						
Other						
Management actions:						
Changes in assumptions						

Earnings on surplus						
Other						
Income taxes						
= Net income						

Investment performance

20.6.20 Investment performance is one of the key determinants of an insurer's profitability. In addition, for many life insurance policies, returns that policyholders receive may be either directly or indirectly influenced by the performance of an insurer's investments. Disclosure of investment performance is therefore essential to market participants.

20.6.21 It may be expected that disclosure of investment performance is made on appropriate subsets of an insurer's assets (for example, assets belonging to the insurer's life insurance business, assets belonging to statutory or notionally segregated portfolios, assets backing a group of investment-linked contracts, assets grouped as the same asset class).

20.6.22 For investment performance disclosure related to equity securities, debt securities, properties and loans, an insurer may disclose a breakdown of income (e.g. dividend receipts, interest income, rental income), realised gains/losses, unrealised gains/losses, impairments including changes in loan loss provisions and investment expenses.

20.6.23 It may be appropriate if an insurer separately discloses the impact of amortisation and impairment of intangible assets on financial performance.

20.7 Disclosure about the financial position of the insurer includes appropriately detailed quantitative and qualitative information on all reasonably foreseeable and relevant material insurance risk exposures and their management. This disclosure must include information on its objectives and policies, models and techniques for managing insurance risks (including underwriting processes). At a minimum, disclosures must include:

- **information about the nature, scale and complexity of risks arising from insurance contracts;**
- **how the insurer uses reinsurance or other forms of risk transfer;**
- **an understanding of the interaction between capital adequacy and risk; and**
- **a description of risk concentrations.**

20.7.1 This disclosure may include a description of the insurer's appetite for insurance risks and its policies for identifying, measuring, monitoring and controlling insurance risks. Such disclosure should be consistent with how the risks are being managed, including information on the models and techniques used.

20.7.2 It may be useful if insurers provide information on their reinsurers, the adequacy of their reinsurance cover, how reinsurance is obtained and on the credit risk of the reinsurance cover.

20.7.3 The reason for requiring information about how an insurer uses reinsurance and other forms of risk transfer is to enable market participants to understand how it controls its exposure to insurance risks.

20.7.4 Since reinsurance programs are often very complex and highly individual, quantitative data may be supplemented by qualitative information. A description of the insurer's overall reinsurance cover may be disclosed explaining the net risk retained and the types of reinsurance arrangements made (treaty, facultative, proportional or non-proportional) as well as any risk mitigating devices that reduce the risks arising out of the reinsurance cover. It may be appropriate that the reinsurance result – the cost of reinsurance less recovery from reinsurance of incurred claims – is disclosed. The cost of reinsurance includes reinsurance premiums as well as foregone investment return from these reinsurance premiums.

20.7.5 It may be beneficial if the insurer discloses the total amount of reinsurance assets included in the balance sheet, showing separately the reinsurers' share of technical provisions and receivables from reinsurers on settled claims. Further quantitative information on reinsurance may be given including:

- the credit quality of the reinsurers, for example, by grouping reinsurance assets by credit rating
- credit risk concentration of reinsurance assets
- the proportion of the reinsurers that are supervised
- the nature and amount of collateral held against reinsurance assets
- the development of reinsurance assets over time
- the ageing of receivables from reinsurers on settled claims.

20.7.6 It may be useful if the insurer discloses the impact and planned action when the expected level or scope of cover from a reinsurance/risk transfer contract is not obtained.

20.7.7 Disclosure of risk concentrations includes the significance of those concentrations and a description of the extent to which the risk is reduced by reinsurance and other risk mitigating elements.

20.7.8 It would be advantageous if the description of the insurer's risk concentrations includes, as a minimum, information on the geographical concentration of insurance risk, the economic sectoral concentration of insurance risk, and if relevant, the risk concentration inherent in the reinsurance cover.

20.7.9 It may be appropriate if, as a minimum, the geographical concentration of premiums is disclosed. The geographical concentration may be based on where the insured risk is located, rather than where the business is written.

20.7.10 It would be helpful if insurers disclose information on the risk concentration inherent in the reinsurance cover. It is suggested that as a minimum, insurers disclose the number of reinsurers that it engages, as well as the highest concentration ratios. For example, it would be appropriate for insurers to disclose their highest premium concentration ratios, which shows the premiums ceded to an insurer's largest reinsurers in aggregate, as a ratio of the total reinsurance premium ceded.

20.7.11 It may useful if insurers consider which other concentrations, in addition to those mentioned above, need also to be disclosed.

20.7.12 It may be useful if insurers include information on the use of derivatives to hedge risks. This information could include a summary of internal policies on the use of derivatives.

20.7.13 Where a group (as defined for any of the purposes set out in Guidance 20.0.15) includes insurers and entities in other businesses, disclosures about risks could include the risk exposure of the insurers to those other entities and procedures in place to mitigate those risks.

20.7.14 It is suggested that an insurer discloses whether or not it carries out stress tests or sensitivity analysis on its investment risk exposures, and, if so, it discloses the process and types of assumptions used and the manner in which the results are used as part of its investment risk management practices.

20.8 Disclosure includes appropriately detailed information about the company profile, including the nature of its business, a general description of its key products, the external environment in which it operates and information on the insurer's objectives and the strategies in place to achieve them.

20.8.1 Often the disclosures provided in the company profile section will describe the intrinsic nature of the business and the external environment in which the insurer operates. The purpose of this section is to assist market participants in assessing the strategies adopted by the business. It is the responsibility of the insurer to decide how best to structure and present the information.

20.8.2 Disclosure at an excessive level of detail may overwhelm market participants and incur unnecessary costs for the insurer. It is also expected that the insurer should avoid generic disclosure. The overall aim of the disclosures is to provide a contextual framework to the quantitative information made public.

20.8.3 It is suggested that the insurer discloses information about its corporate structure focusing on material aspects both in terms of the legal entities within the corporate structure and the business functions undertaken within the group. The disclosures may include any material changes that have taken place during the year. Information on and changes in the management, structure and organisation of its key functions including investment, risk management, underwriting and claims could be disclosed. In the event of differences in the composition of a group for supervisory purposes and for public reporting purposes (as outlined in Guidance 20.3.4), it is suggested that a description of the entities constituting those differences is provided.

20.8.4 It would be appropriate if the insurer also discloses the main trends and factors that have contributed positively or negatively to the development, performance and position of the firm.

20.8.5 It may be useful that the insurer discloses its competitive position and its business models (such as its approach to dealing and settling claims, acquiring new business, etc) as well as significant features of regulatory and legal issues affecting the business.

20.8.6 The insurer may disclose its financial and non-financial objectives, along with the time frames and the strategies for achieving them. This disclosure will enable market participants to assess these objectives and the insurer's ability to achieve them. It may be appropriate if the insurer also explains significant changes in strategy compared to prior years. Disclosures include information about the general strategy and objectives, performance management, business rationale and underlying risks, the approach to risk tolerance and methods used to reduce and/or mitigate risks.

20.8.7 It may be useful if the insurer discloses the range of risks it faces, including the key external and internal risks and opportunities that may affect its ability to achieve its objectives. It may also be useful if the insurer also discloses the impact of such risks and how the entity is planning to manage them.

20.8.8 Suitable disclosure may include a description of the key resources and the risks that could have an impact on the insurer’s objectives. Key resources include both the financial and non-financial resources available. For non-financial resources the insurer may, for example, provide information about its human and intellectual capital, processes, systems and reputation.

20.8.9 Disclosures could include a quantitative analysis of the insurer’s sensitivity to changes in key factors taking into account, the effect of derivatives and other forms of risk mitigation on that sensitivity (see Table 20.4 for an example of the type of sensitivity analysis that could be disclosed).

20.8.10 It may be appropriate if life insurers disclose sensitivity analysis to the changes in mortality and disability assumptions.

Table 20.4: Example: Sensitivity Analysis of Technical Provisions by Major Assumption						
	Segment A		**Segment B**		**Total**	
	Current Year	**Previous Year**	**Current Year**	**Previous Year**	**Current Year**	**Previous Year**
Interest Rates:						
Expected Income						
Actual Income						
Ratio A/E						
Effect of 1% Decrease in Yield Curve						
Mortality Rates:						
Expected Claims						
Actual Claims						
Ratio A/E						
Effect of 1% increase in mortality rates						
Admin Expenses:						
Expected expenses						
Actual expense						
Ratio A/E						
Effect of 1 % increase in expenses						
Surrenders:						
Expected surrenders						
Actual surrenders						
Ration A/E						
Effect of 10 % increase in surrenders						

Effect of 10% decrease in surrenders Etc						

20.9 Disclosures include the key features of the insurer's corporate governance framework and management controls including how these are implemented.

20.9.1 Where a key business function of an insurer is outsourced in part or in whole to external parties (including outsourcing to related entities within the insurance group or financial conglomerate), it may be appropriate if the insurer describes its outsourcing policy and how it maintains control, ownership and oversight over the outsourced function.

20.9.2 An insurer's disclosures may appropriately include the manner in which key business functions are organised within its organisation structure, the mechanism used by the Board to oversee the functions, changes to key personnel and other management infrastructure. Such a discussion also demonstrates how the key business functions fit into an insurer's overall risk management framework.

20.10 Subject to the nature, scale and complexity of an insurer, supervisors require insurers to produce, at least annually, audited financial statements and make them available to market participants.

20.10.1 As part of considering the nature, scale and complexity of an insurer for the purposes of this standard, where audited financial statements are not available (for example some small mutual insurers in some jurisdictions), it may be appropriate if supervisors ensure that similar information is publicly available by other means.

ICP 21 Countering Fraud in Insurance

The supervisor requires that insurers and intermediaries take effective measures to deter, prevent, detect, report and remedy fraud in insurance.

Introductory Guidance

21.0.1 Fraud in insurance (including reinsurance) is a deceptive act or omission intended to gain advantage for a party committing the fraud (the fraudster) or for other parties. Most jurisdictions have legal provisions against fraud in insurance. In many jurisdictions, instances of fraud are criminal acts.

21.0.2 Fraud in insurance can take many forms and be perpetrated by any party involved in insurance, including insurers, insurers' managers and staff, intermediaries, accountants, auditors, consultants, claims adjusters, third party claimants and policyholders.

21.0.3 Fraud poses a serious risk to all financial sectors; fraud in insurance results in reputational as well as financial damage and social and economic costs. In the insurance sector, both insurers and policyholders bear the costs. Losses caused by fraudulent activities affect insurers' profits and potentially their financial soundness. To compensate, insurers raise premiums and this results in higher costs for policyholders. Fraud may also result in the policyholder discovering that they are not insured for risks they believed were covered, which can have a material impact on both customers and businesses. For these reasons, fraud may reduce consumer and shareholder confidence. It can affect the reputation of individual insurers, insurance groups, the insurance sector and, potentially, economic stability more broadly.

21.0.4 Countering fraud is in principle the concern of the individual insurers and intermediaries. Insurers and intermediaries need to understand and take steps to minimise their vulnerability to fraud.

21.0.5 Responsibility for ensuring that insurers and intermediaries have adequate fraud risk management ultimately lies with the Board and Senior Management of the insurer or intermediary.

21.0.6 The supervisor is one of the competent authorities that has an important role to play in countering fraud in insurance in its jurisdiction. There may be jurisdictions where several authorities have a responsibility for deterring, preventing, detecting, reporting and remedying fraud in insurance.

21.0.7 Fraud in insurance is an issue for supervisors if the risk of fraud is not addressed adequately. Therefore, supervisors should pay appropriate attention as to whether insurers and intermediaries have adequate and effective policies, procedures and controls in place to deter, prevent, detect, report and remedy fraud.

21.0.8 The increasing integration of financial markets and the growing number of internationally active insurers and intermediaries make fraud and its potential global implications an important issue to address at the

international level. Therefore, it is important that supervisors communicate with one another in addressing fraud across jurisdictions.

21.0.9 The supervisor should consider the application of these standards, particularly for intermediaries, taking into account that there are various business models ranging from sole traders to large enterprises.

21.0.10 The IAIS *Application paper on deterring, preventing, detecting, reporting and remedying fraud in insurance* includes guidance on how insurers and intermediaries can deter, prevent, detect, report and remedy fraud effectively.

21.1 Fraud in insurance is addressed by legislation which prescribes adequate sanctions for committing such fraud and for prejudicing an investigation into fraud.

21.1.1 Legislation should contain offences and sanctions for committing fraud and for prejudicing an investigation into fraud. It should also provide the ability:

- to obtain documents and information, together with statements made by relevant individuals, for intelligence and investigation purposes, for disclosure to appropriate authorities;
- to restrain assets which represent, or are believed to represent, the proceeds of fraud; and
- to confiscate assets which are, or are believed to be, the proceeds of fraud.

21.1.2 It may be helpful for anti-fraud legislation to provide appropriate civil and criminal immunity for fraud reporting in good faith, including where no fraud was subsequently found to have occurred.

21.2 The supervisor has a thorough and comprehensive understanding of the types of fraud risk to which insurers and intermediaries are exposed. The supervisor regularly assesses the potential fraud risks to the insurance sector and requires insurers and intermediaries to take effective measures to address those risks.

21.2.1 The supervisor should identify the main vulnerabilities in its jurisdiction, taking into account independent risk assessments where relevant, and address them accordingly. These are not static assessments. They will change over time, depending on how circumstances develop, and how threats evolve.

21.2.2 The supervisor should have a thorough and comprehensive understanding of:

- the activities undertaken and products and services offered by insurers and intermediaries; and
- internal, policyholder, claims and intermediary fraud.

21.2.3 The supervisor should consider the potential fraud risks alongside other risk assessments (including governance and market conduct) arising from its wider duties and be aware of the relevance of fraud to the duties it carries out in respect of other ICPs and standards.

21.3 The supervisor has an effective supervisory framework to monitor and enforce compliance by insurers and intermediaries with the requirements to counter fraud in insurance.

21.3.1 The supervisor should issue anti-fraud requirements by way of regulations, instructions or other documents or mechanisms that set out enforceable requirements with sanctions for non-compliance with the requirements.

21.3.2 The supervisor should issue guidance to insurers and intermediaries that will assist them to counter fraud effectively and to meet the requirements set by the supervisor.

21.3.3 The supervisor should have sufficient financial, human and technical resources to counter fraud, including the resources needed to be able to issue and enforce sanctions in relation to complex cases where insurers or intermediaries oppose such sanctions.

21.3.4 The staff of the supervisor engaging in anti-fraud activity should be appropriately skilled and provided with adequate and relevant training on countering fraud. Examples of issues to be covered under adequate and relevant training for the staff of the supervisor include fraud legislation (including offences), fraud typologies, techniques to be used by supervisors to ensure that insurers and intermediaries are complying with their obligations, and the issue and enforcement of sanctions. Similarly, insurers and intermediaries should provide relevant training on anti-fraud measures to Board Members, Senior Management and other staff as appropriate.

21.3.5 The supervisor should take account of the risk of fraud at each stage of the supervisory process, where relevant, including the licensing stage.

21.3.6 The supervisor should assess whether insurers and intermediaries have adequate fraud risk management systems in place which are reviewed regularly. Insurers and intermediaries should be able to demonstrate to the supervisor that they have effective management of their fraud risk and possible risks to their solvency or continuity caused by fraud. At a minimum the supervisor should assess whether insurers and intermediaries:

- have effective policies, procedures and controls in place to deter, prevent, detect, report and remedy fraud;
- have an independent internal audit function and periodically carry out fraud-sensitive audits; and
- have allocated appropriate resources to deter, prevent, detect, record and, as required, promptly report fraud to the relevant authorities.

21.3.7 The supervisor should use both off-site monitoring and on-site inspections to:

- evaluate the effectiveness of the internal control system of insurers and intermediaries to manage fraud risks; and

- recommend or require appropriate remedial action where the internal control system is weak and monitor the implementation of such remedial actions.

21.3.8 As particular fraud risks arise from claims, the supervisor should cover claims management processes in its supervision. This may include reviewing and assessing claims data, the quality of client acceptances, and claims handling processes. Regarding the risks of fraud occurring in the underwriting process, the supervisor should review relevant processes and controls, in particular those concerned with verification of customer information.

21.3.9 The supervisor should have the power to take appropriate corrective and remedial action where insurers and intermediaries do not implement anti-fraud requirements effectively or in cases of fraud committed by the insurer or intermediary. Depending on the severity of the situation and level of supervisory powers, this could include letters to management, directions, fines, the suspension of business, the appointment of alternative management and redress to customers.

21.3.10 Where a supervisor identifies suspected criminal activities in an insurer or intermediary it should ensure that relevant information is provided to the financial intelligence unit (FIU) and appropriate law enforcement agency and any other relevant supervisors.

21.4 The supervisor regularly reviews the effectiveness of the measures insurers and intermediaries and the supervisor itself are taking to deter, prevent, detect, report and remedy fraud. The supervisor takes any necessary action to improve effectiveness.

21.4.1 The review of effectiveness should take risk into account and assess whether established regulations and supervisory practices are being enforced.

21.4.2 This review could cover aspects such as:

- the risks of fraud in the insurance sector and whether these are adequately addressed by the risk-based approach of the supervisor
- the adequacy of the supervisor's resources and training
- whether the number and content of on-site inspections relating to anti-fraud measures are adequate
- whether off-site supervision of anti-fraud measures is adequate
- the findings of on-site inspections, including the effectiveness of training and implementation by insurers and intermediaries of anti-fraud measures
- action taken by the supervisor against insurers and intermediaries
- input from other authorities with anti-fraud responsibilities, such as information on fraud prosecutions and convictions
- the number and nature of requests for information from other authorities concerning anti-fraud matters, and

- the adequacy of the requirements, guidance and other information provided by the supervisor to the sector which may vary on the basis of the business undertaken.

Such reviews should enable the supervisor to identify any necessary actions which need to be taken to improve effectiveness.

21.4.3 The supervisor should consider contributing to or promoting anti-fraud initiatives such as:

- working with relevant industry and trade associations to encourage and maintain an industry-wide approach to deterring, preventing, detecting, reporting and remedying fraud
- the establishment of anti-fraud committees consisting of industry or trade organisations, law enforcement agencies, other supervisors, other authorities and possibly consumer organisations as a platform to address fraud in insurance – for example, by discussing trends, risks, policy issues, profiles and modus operandi
- the establishment of a fraud database on suspected and/or confirmed fraud attempts; insurers could be requested or required to submit information and statistics with respect to these attempts
- the exchange of information between insurers and intermediaries on fraud and fraudsters including, as appropriate, through the use of databases to the extent permitted by local legislation
- the enhancement of consumer/policyholder awareness on insurance fraud and its effects through effective education and media campaigns
- cooperation between organisations involved with combating fraud in the insurance sector, such as organisations for accountants, forensic auditors and claims adjustors.

21.4.4 Whenever a supervisor is informed of substantiated suspicious fraudulent activities which might affect insurers, intermediaries or the insurance industry as a whole, it should consider whether to convey warning information to insurers and intermediaries to the extent permitted by local legislation.

21.4.5 The supervisor should maintain records on the number of on-site inspections relating to the combating of fraud measures and on sanctions it has issued to insurers and intermediaries with regard to inadequate anti-fraud measures.

21.5 The supervisor has effective mechanisms in place, which enable it to cooperate, coordinate and exchange information with other competent authorities, such as law enforcement authorities, as well as other supervisors concerning the development and implementation of policies and activities to deter, prevent, detect, report and remedy fraud in insurance.

21.5.1 Mechanisms of cooperation and coordination should normally address:

- operational cooperation and, where appropriate, coordination between supervisors and other anti-fraud competent authorities; and
- policy cooperation and, where appropriate, coordination across all relevant anti-fraud competent authorities.

21.5.2 Where the supervisor identifies suspected fraud in insurers or intermediaries it should ensure that relevant information is provided to the FIU and appropriate law enforcement agency and any other relevant supervisors.

21.5.3 The supervisor should take all necessary steps to cooperate and exchange information with other relevant authorities. There should be contact by the supervisor with the FIU and appropriate law enforcement agency to ascertain any concerns it has and any concerns expressed by insurers and intermediaries and to obtain feedback on trends in reported cases.

21.5.4 The supervisor should consider appointing within its office a contact for anti-fraud issues and for liaising with other competent authorities to promote an efficient exchange of information.

21.5.5 The supervisor should maintain records on the number and nature of formal requests for assistance made by or received from supervisors or law enforcement agencies concerning fraud or potential fraud, including whether the request was granted or refused.

ICP 22 Anti-Money Laundering and Combating the Financing of Terrorism[79]

The supervisor requires insurers and intermediaries to take effective measures to combat money laundering and the financing of terrorism. In addition, the supervisor takes effective measures to combat money laundering and the financing of terrorism.

Introductory Guidance

22.0.1 Money laundering is the processing of criminal proceeds to disguise their illegal origin. Terrorist financing is the wilful provision or collection of funds by any means, directly or indirectly, with the unlawful intention that they should be used, or in the knowledge that they are to be used, in full or in part:

- to carry out a terrorist act(s);
- by a terrorist organisation; or
- by an individual terrorist.

The insurance sector and other financial services sectors are potentially at risk of being misused, knowingly or unknowingly, for money laundering (ML) and the financing of terrorism (FT). This exposes them to legal, operational and reputational risks.

22.0.2 This ICP and related standards and guidance on anti-money laundering (AML) and combating the financing of terrorism (CFT) apply at a minimum to the supervision of those insurers and intermediaries underwriting or placing life insurance and other investment-related insurance.

22.0.3 The supervisor should have a risk-based approach towards the measures that it takes as well as towards those required of insurers and intermediaries.

22.0.4 The supervisor should, on the basis of an analysis of the risk of ML/FT, consider whether or not and to what extent this ICP and related standards and guidance should apply to the non-life sector.

22.0.5 The IAIS Application Paper on combating money laundering and terrorist financing[80] provides instructive information on what the Financial Action Task Force (FATF) requires by way of law and enforceable means, and provides information on how insurers and insurance intermediaries can meet the FATF's AML/CFT requirements.

The FATF Recommendations and the IAIS approach

[79] ICP 22 Anti-Money Laundering and Combating the Financing of Terrorism was revised in 2013. The new ICP 22 was adopted at the IAIS General Meeting on 19 October 2013.

[80] This Application Paper is intended to provide specific information for insurance supervisors and the insurance sector in tailoring AML/CFT standards to the specific practices and features of the insurance sector. The ICP and the Application Paper do not replace the FATF's requirements.

22.0.6 The FATF is an inter-governmental body, established to set international standards for AML/CFT. The FATF has developed recommendations on AML/CFT (collectively referred to here as "FATF Recommendations"), some of which are applicable to the insurance sector.

22.0.7 The FATF Recommendations apply at a minimum to the underwriting and placement of life insurance and other investment-related insurance. In addition, where the non-life sector, or part of that sector, is assessed by a jurisdiction as posing a ML/FT risk the FATF standards require that the jurisdiction considers applying the FATF standards to that sector.

22.0.8 The FATF requires jurisdictions to designate a competent authority or authorities to have responsibility for ensuring that financial institutions (including insurers and intermediaries) adequately comply with the FATF Recommendations to combat ML/FT. The AML/CFT competent authority is often designated by a jurisdiction's legislation. There may be jurisdictions where several authorities have AML/CFT responsibilities for the insurance sector.

22.0.9 Insurance supervisors are not always designated as the competent authority for AML/CFT in their jurisdiction. Other competent authorities could include law enforcement agencies, and a financial intelligence unit (FIU) which serves as a national centre for receiving and analysing information (such as suspicious transaction reports) and disseminating information regarding potential ML/FT. However, while the insurance supervisor may not be the designated competent authority, this does not absolve it from understanding the risk of ML/FT to the insurance sector and taking steps to help combat ML/FT.

22.0.10 Therefore the standards and guidance related to this principle are divided into two parts. Part A applies where the insurance supervisor is a designated AML/CFT competent authority or acts on behalf of a designated competent authority. Part B applies where the insurance supervisor is not a designated AML/CFT competent authority for the insurance sector. To demonstrate observance of this ICP the supervisor must meet the requirements of the standards in either part A or part B according to the circumstances of the jurisdiction.

Part A: Where the insurance supervisor is a designated AML/CFT competent authority

22.1 The supervisor has a thorough and comprehensive understanding of the ML/FT risks to which insurers and intermediaries are exposed, and uses available information to assess the ML/FT risks to the insurance sector in its jurisdiction on a regular basis.

Understanding ML/FT risks

22.1.1 The supervisor should have a thorough and comprehensive understanding of the ML/FT risks to which insurers and intermediaries are exposed arising from the activities undertaken and products and services offered by insurers and intermediaries.[81]

[81] The Financial Action Task Force has published a paper: *Risk-Based Approach: Guidance for the Life Insurance Sector* (October 2009). The IAIS expects this paper to be revised after 2013.

22.1.2 The following features may increase the ML/FT risk profile of an insurance product/service:

- acceptance of payments or receipts from third parties
- acceptance of very high value or unlimited value payments or large volumes of lower value payments
- acceptance of payments made in cash, money orders or cashier cheques
- acceptance of frequent payments outside a normal premium policy or payment schedule
- allowance of withdrawals at any time with limited charges or fees
- acceptance to be used as collateral for a loan and/or written in a discretionary or other increased risk trust
- products with features that allow loans to be taken against the policy (particularly if frequent loans can be taken and/or repaid with cash)
- products that allow for high cash values
- products that accept high amount lump sum payments, coupled with liquidity features
- products with cooling off provisions[82] where the request is made to send the refunded monies to an unrelated third party, a foreign financial institution, or to an entity located in a high risk jurisdiction
- products that allow for assignment without the insurer being aware that the beneficiary of the contract has been changed until such time as a claim is made
- the extent and nature of cross-border activity.

It should be noted that some of the above features can be expected over the course of a long-term insurance contract and are not necessarily inherently suspicious.

22.1.3 Examples of how ML/FT can occur in insurance are provided in the IAIS Application Paper on combating money laundering and terrorist financing.

Assessing ML/FT risks

22.1.4 The supervisor should use available information to assess the main ML/FT risks[83] to the insurance sector in their jurisdiction and address them accordingly. Such risk assessments may provide for recommendations on the allocation of responsibilities and resources at the jurisdictional level based on a comprehensive and up-to-date understanding of the risks. These are not static assessments. They will change over time, depending on how circumstances develop, and how

[82] Provisions that allow a policy to be cancelled within a stipulated timeframe and the premiums paid to be refunded (in some jurisdictions these are known as "free look").
[83] For the purposes of this ICP 'risk' encompasses the concepts of vulnerabilities and threats.

risks evolve. For this reason risk assessments should be undertaken on a regular basis and kept up to date.

22.1.5 The supervisor should consider the potential ML/FT risks alongside other risk assessments (including governance and market conduct) arising from its wider duties and be aware of the relevance of ML/FT to the duties it carries out in respect of other ICPs and standards.

22.1.6 When a jurisdiction-wide risk assessment has been conducted, the supervisor should have access to it and take account of it. The supervisor should participate in such an assessment to inform the assessment and also to improve its understanding of the risks.[84]

22.2 The supervisor:

- **issues to insurers and intermediaries enforceable rules on AML/CFT obligations consistent with the FATF Recommendations, for matters which are not in law;**
- **establishes guidance that will assist insurers and intermediaries to implement and comply with their respective AML/CFT requirements; and**
- **provides insurers and intermediaries with adequate and appropriate feedback to promote AML/CFT compliance.**

22.2.1 Whilst the FATF requires the basic obligations of customer due diligence, record keeping and the reporting of suspicion to be set in law, the more detailed elements for technical compliance may be set in law or enforceable means.[85] For the purpose of this standard these "enforceable means" are described as "enforceable rules".

22.2.2 Enforceable rules are a document or mechanism that sets out enforceable AML/CFT requirements in mandatory language with sanctions for non-compliance and which are issued or approved by the supervisor.

22.2.3 The supervisor should require insurers and intermediaries to take appropriate steps to identify, assess and understand their ML/FT risks (for customers, jurisdictions, countries or geographic areas; and products, services, transactions or delivery channels). The supervisor should also require insurers and intermediaries to manage and mitigate the ML/FT risks that have been identified.

22.2.4 The supervisor should promote a clear understanding by insurers and intermediaries of their AML/CFT obligations and ML/FT risks. Examples of ways to achieve this are to engage with insurers and intermediaries and to provide information on supervision. This might include the supervisor providing guidance which gives assistance on issues covered

[84] In February 2013 the FATF published guidance on National Money Laundering and Terrorist Financing Risk Assessment.

[85] The FATF's Methodology for assessing compliance with the FATF Recommendations and the effectiveness of AML/CFT systems refers to "law", which is any legislation issued or approved through a Parliamentary process or other equivalent means provided for under the country's constitutional framework, which imposes mandatory requirements with sanctions for non-compliance; and "enforceable means", which are regulations, guidelines, instructions or other documents or mechanisms that set out enforceable requirements in mandatory language with sanctions for non-compliance.

under the relevant FATF Recommendations, including, as a minimum, possible techniques and methods to combat ML/FT and any additional measures that insurers and intermediaries could take to ensure that their AML/CFT measures are effective. Such guidance may not necessarily be enforceable but will assist insurers and intermediaries to implement and comply with AML/CFT requirements.

22.2.5 Examples of appropriate feedback mechanisms by supervisors may include information on current ML/FT techniques, methods and trends (typologies), sanitised examples of actual ML/FT, examples of failures or weaknesses in AML/CFT systems by insurers and intermediaries and lessons to be learned. It may be appropriate for the supervisor to refer to guidance or contribute to feedback from other sources, for example industry guidance.

22.3 The supervisor has an effective supervisory framework to monitor and enforce compliance by insurers and intermediaries with AML/CFT requirements.

22.3.1 The supervisor should take account of the risk of ML/FT at each stage of the supervisory process, where relevant, including the licensing stage.

22.3.2 The supervisor should have adequate financial, human and technical resources to combat ML/FT, including resources needed to be able to impose sanctions effectively in relation to complex cases where supervisory action is resisted by insurers or intermediaries.

22.3.3 The supervisor should subject insurers and intermediaries to supervisory review (off-site monitoring and/or on-site inspection) of their compliance with the AML/CFT requirements and, on the basis of the information arising from such monitoring and any other information acquired, assess the ML/FT risk profile of the insurer or intermediary.

22.3.4 The frequency and intensity of supervisory review should be based on:

- the ML/FT risks and the policies, internal controls and procedures of each insurer and intermediary, as identified by the supervisor's assessment of their risk profile;
- the ML/FT risks present in the jurisdiction;
- the characteristics of insurers or intermediaries, in particular their number and diversity and the degree of discretion allowed to them under the risk-based approach.

22.3.5 Staff of the supervisor should be appropriately skilled and provided with adequate and relevant training for combating ML/FT, including the necessary skills and knowledge to assess the quality and effectiveness of firms' AML/CFT systems and controls.

22.3.6 The supervisor should require insurers and intermediaries to undertake AML/CFT assessments and develop risk profiles of their customers, business relationships, distribution channels, products and services and to put in place risk management and control measures to address identified risks.

22.3.7 The supervisor should have the power to take appropriate corrective, remedial and enforcement action where insurers and intermediaries do not implement AML/CFT requirements effectively.

22.3.8 The supervisor should also require insurers and intermediaries to provide relevant training in AML/CFT to Board Members, Senior Management and other staff as appropriate.

22.4 The supervisor regularly reviews the effectiveness of the measures that insurers and intermediaries and the supervisor itself are taking on AML/CFT. The supervisor takes any necessary action to improve effectiveness.

22.4.1 The review should include an assessment of the effectiveness of implementation of AML/CFT requirements and of the supervisory approach, including but not limited to the extent to which the supervisor's actions have an effect on compliance by insurers and intermediaries.

22.4.2 This review could cover aspects such as:

- the risks of ML/FT in the insurance sector and whether these are adequately addressed by the risk-based approach of the supervisor;
- the adequacy of the supervisor's resources and training;
- whether the number and content of on-site inspections relating to AML/CFT measures is adequate;
- whether AML/CFT off-site supervision is adequate;
- the findings of on-site inspections, including the effectiveness of training and implementation by insurers and intermediaries of AML/CFT measures;
- action taken by the supervisor against insurers and intermediaries;
- input from other authorities on the insurance sector, such as the number and pattern of suspicious transaction reports made by insurers and intermediaries, and ML/FT prosecutions and convictions in the insurance sector;
- the number and nature of requests for information from other authorities concerning AML/CFT matters;
- the adequacy of the requirements, guidance and other information provided by the supervisor to the sector;
- the number and type of ML/FT prosecutions and convictions in the insurance sector.

Such reviews should enable the supervisor to identify any necessary actions which need to be taken to improve effectiveness.

22.4.3 The supervisor should maintain records on the number of on-site inspections relating to AML/CFT measures and on sanctions it has issued to insurers and intermediaries with regard to inadequate AML/CFT measures.

22.5 The supervisor has effective mechanisms in place which enable it to cooperate, coordinate and exchange information with other domestic authorities, such as the financial intelligence unit, as well as with supervisors in other jurisdictions for AML/CFT purposes.

22.5.1 Mechanisms of cooperation, coordination and exchange of information should normally address:

- operational cooperation and, where appropriate, coordination between the FIU, law enforcement agency and supervisors; and
- policy cooperation and, where appropriate, coordination across all relevant AML/CFT competent authorities.

Effective prevention of ML/FT is enhanced by close cooperation among supervisors, the FIU, law enforcement agencies, other competent authorities, and insurers and intermediaries.

22.5.2 Where a supervisor identifies suspected ML/FT in insurers and intermediaries, it should ensure that relevant information is provided to the FIU, any appropriate law enforcement agency and other relevant supervisors.

22.5.3 The supervisor should take all necessary steps to cooperate, coordinate and exchange information with the other relevant authorities. There should be contact by the supervisor with the FIU and appropriate law enforcement agency to ascertain any concerns it has and any concerns expressed on AML/CFT compliance by insurers and intermediaries, to obtain feedback on trends in reported cases and to obtain information regarding potential ML/FT risks to the insurance sector.

22.5.4 The supervisor should consider appointing within its office a contact for AML/CFT issues and to liaise with other AML/CFT competent authorities to promote an efficient exchange of information.

22.5.5 The exchange of information is subject to confidentiality considerations. These are discussed in ICP 3 Information Exchange and Confidentiality Requirements.

Part B: Where the insurance supervisor is not a designated AML/CFT competent authority

22.6 The supervisor is aware of and has an understanding of ML/FT risks to which insurers and intermediaries are exposed. It liaises with and seeks to obtain information from the designated competent authority relating to AML/CFT by insurers and insurance intermediaries.

22.6.1 Where another body is the AML/CFT designated competent authority,[86] the supervisor should consider what effect this may have on its ability to ensure that insurers and insurance intermediaries meet supervisory requirements.

22.6.2 The supervisor should have an understanding of the ML/FT risks to which insurers and intermediaries are exposed arising from the activities undertaken and products and services offered by insurers and intermediaries.

22.6.3 The supervisor is able to make a more informed evaluation and judgment on the soundness of insurers and intermediaries by receiving information from the AML/CFT designated competent authority. Such information

[86] Including where more than one body is designated as a competent authority for AML/CFT.

may be relevant to the risk profile of the insurer or intermediary or to the effectiveness of risk management by the insurer or intermediary. The contents of this information may include the level of ML/FT risks to which insurers and intermediaries are exposed, and the designated competent authority's views on the risk management, corporate governance and internal control measures of supervised entities relevant to AML/CFT.

22.6.4 The AML/CFT designated competent authority may have information on breaches of AML/CFT requirements that should be taken into consideration by the supervisor in its supervisory activities, such as when evaluating the Board, Senior Management and Key Persons in Control Functions on the basis of suitability requirements including when reviewing licence applications.

22.7 The supervisor has effective mechanisms in place which enable it to cooperate, coordinate and exchange information with other domestic authorities, such as the financial intelligence unit, as well as with supervisors in other jurisdictions for AML/CFT purposes.

22.7.1 Mechanisms of cooperation, coordination and exchange of information should normally address operational cooperation and, where appropriate, coordination between the FIU, law enforcement agencies and other supervisors. Effective prevention of ML/FT is enhanced by close cooperation among supervisors, the FIU, law enforcement agencies, other competent authorities, and insurers and intermediaries.

22.7.2 Where in the course of exercising its supervisory responsibilities the supervisor becomes aware of information on ML/FT risks, it should provide relevant information to the designated competent authority. Where a supervisor identifies suspected ML/FT in insurers and intermediaries, it should ensure that relevant information is provided to the FIU, appropriate law enforcement agency and any other relevant supervisors.

22.7.3 As part of its cooperation with the AML/CFT designated competent authority, the supervisor should provide input into the effectiveness of the AML/CFT framework. This may help the designated competent authority in its consideration of effectiveness.

22.7.4 The exchange of information is subject to confidentiality considerations. These are discussed in ICP 3 Information Exchange and Confidentiality Requirements.

ICP 23 Group-wide Supervision[87]

The group-wide supervisor, in cooperation and coordination with other involved supervisors, identifies the insurance group and determines the scope of group supervision.

Introductory Guidance

23.0.1 Involved supervisors should seek agreement amongst themselves on the identification of the insurance group, including the head of the insurance group, and the scope of group-wide supervision to ensure that gaps or duplication in regulatory oversight between jurisdictions do not occur. If agreement cannot be reached in a timely manner, the ultimate responsibility for determining the identification of the insurance group and scope of group-wide supervision rests with the group-wide supervisor. Decisions should be undertaken on a case-by-case basis and may include discussion with the insurance group.

23.0.2 The group-wide supervisor cooperates and coordinates with other involved supervisors, and should be accountable for the appropriateness of the identification of the insurance group and the determination of the scope of group supervision. In particular, in the case of insurance groups that operate on a cross-border basis, the group-wide supervisor should be able to explain the appropriateness of the identification of the insurance group and the determination of the scope of group supervision to involved supervisors in other jurisdictions. The identification of the insurance group and scope of group supervision should be reviewed regularly by the group-wide supervisor, in cooperation and coordination with other involved supervisors.

23.0.3 The group-wide supervisor should require the head of the insurance group to provide information needed on an ongoing basis to identify the insurance group and to determine the scope of group-wide supervision. The head of the insurance group provides the information to the group-wide supervisor, who disseminates it to the other involved supervisors as needed.

23.1 The group-wide supervisor, in cooperation and coordination with other involved supervisors, identifies all legal entities that are part of the insurance group.

23.1.1 To ascertain the identity of an insurance group, supervisors should first identify all insurance legal entities within the corporate structure.

Supervisors should then identify all entities which have control over those insurance legal entities in the meaning provided for in the definition in ICP 6 (Changes in Control and Portfolio Transfers). If this results in only one identified entity, this entity is the head of the insurance group. If there is more than one entity with control over the insurance legal entities, supervisors should identify the head of the insurance group such as the entity which has the greatest level of control over the insurance business.

[87] Amended November 2015

23.1.2 A practical method for determining the entities within the insurance group is often to start with entities included in the consolidated accounts. The head of an insurance group including an insurance-led financial conglomerate is at least one of the following:

- an insurance legal entity
- a holding company

The identified insurance group includes the head of the insurance group and all the legal entities controlled by the head of the insurance group. Legal entities within a group could include:

- operating and non-operating holding companies (including intermediate holding companies);
- other regulated entities such as banks and/or securities companies;
- non-regulated entities; and
- special purpose entities.

In addition to considering the consolidated accounts, the supervisor should consider other relationships such as

- common Directors;
- membership rights in a mutual or similar entity;
- involvement in the policy-making process; and
- material transactions.

The insurance group may be

- a subset/part of a bank-led or securities-led financial conglomerate; or
- a subset of a wider group, such as a larger diversified conglomerate with both financial and non-financial entities.

23.1.3 Examples of the types of group structures that could be captured by the definition of insurance groups are provided in the diagrams below (Figure 23.1, 23.2, 23.3 and 23.4). These examples are for purposes of illustration only, and are not intended to set forth all possible forms of insurance groups.

23.1.4 The ICPs' definition of "insurance group" may be different from the definitions used in other contexts, such as accounting or tax purposes.

23.2 The group-wide supervisor, in cooperation and coordination with other involved supervisors, determines the scope of group-wide supervision.

23.2.1 Involved supervisors should consult and agree on the scope of group-wide supervision of the insurance group to ensure that there are no gaps and no unnecessary duplication in supervision among jurisdictions.

A practical method to determine the entities to capture within the scope of group-wide supervision is to start with entities included in the consolidated accounts. Entities that are not included in consolidated accounts should be included if they are relevant from the perspective of

risk (non-consolidated entities also subject to supervision) or control. The entities that may be captured within the scope of group-wide supervision may either be incorporated or unincorporated.

23.2.2 In considering the risks to which the insurance group is exposed it is important to take account of those risks that emanate from the wider group within which the insurance group operates.

23.2.3 Individual entities within the insurance group may be excluded from the scope of group-wide supervision if the risks from those entities are negligible or group-wide supervision is impractical.

23.2.4 The exclusion or inclusion of entities within the scope of group-wide supervision should be regularly re-assessed.

23.2.5 It should be noted that the supervisory approach to entities/activities within the insurance group may vary depending on factors such as their types of business, legal status and/or nature, scale and complexity of risks. Although an insurance group as a whole should be subject to group-wide supervision, not all quantitative and qualitative supervisory requirements applied to an insurance legal entity should necessarily be applied to other entities within the group, to the insurance group as a whole, or to a sub-group collectively.

23.3 The group-wide supervisor and other involved supervisors do not narrow the identification of the insurance group or the scope of group-wide supervision due to lack of legal authority or supervisory power over particular legal entities.

23.3.1 In some jurisdictions, the supervisor may not be granted legal authority or supervisory power for the direct supervision of some entities within the identified insurance group or the scope of group-wide supervision. These may include legal entities regulated in another sector or non-regulated entities within the same jurisdiction.

23.3.2 Where a supervisor has no direct legal power over certain legal entities in the scope of the group-wide supervision, the supervisor will use its power over regulated entities and/or consult with other involved supervisors to obtain similar supervisory outcomes.

Illustrations to assist the identification of insurance groups

Figure 23.1 Insurance Group

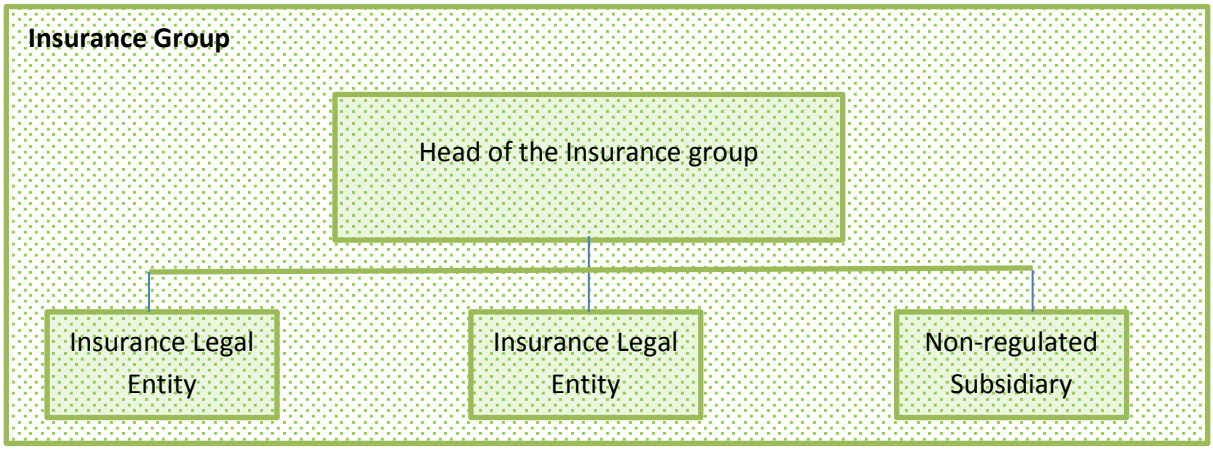


Figure 23.2 Financial Conglomerate

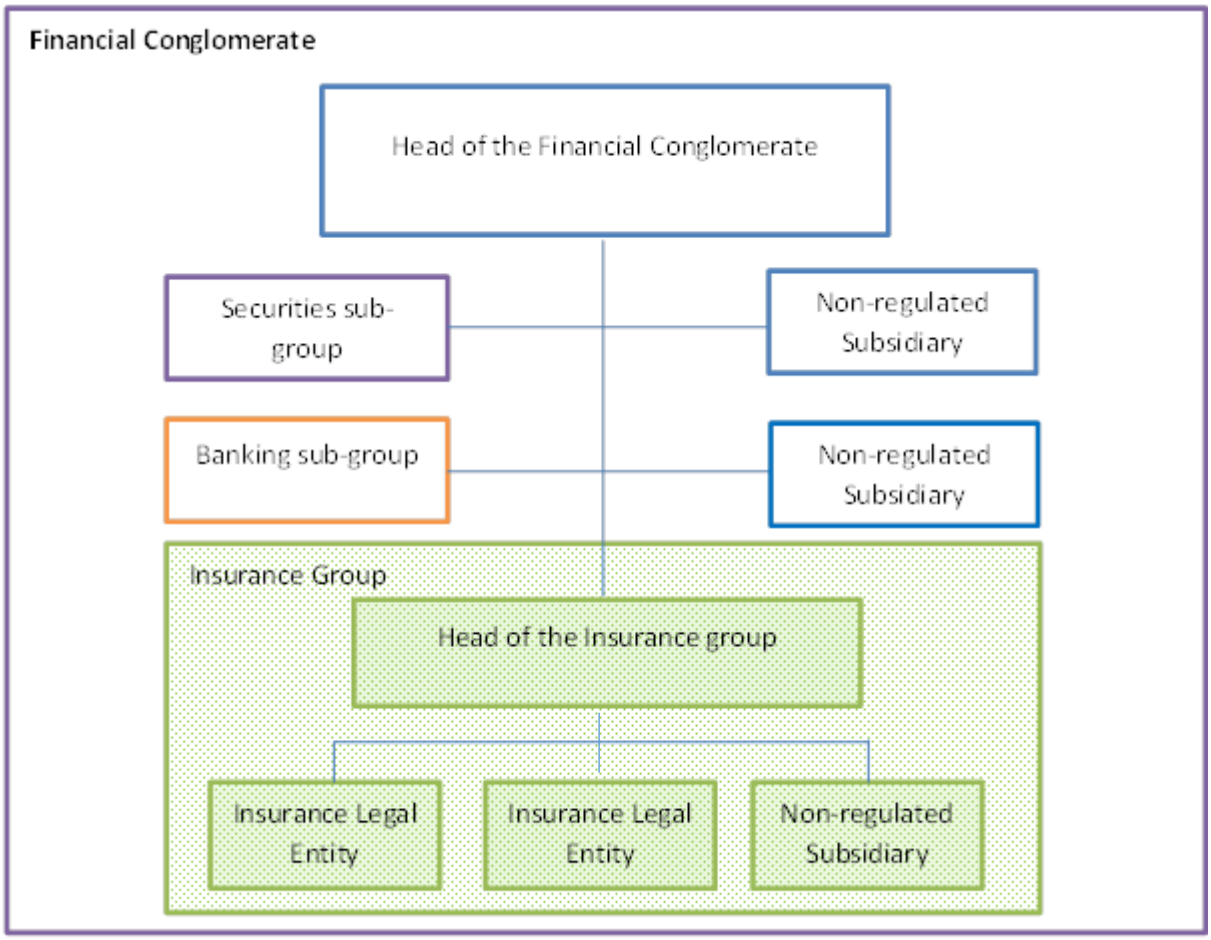


Figure 23.3 Insurance-led Financial Conglomerate

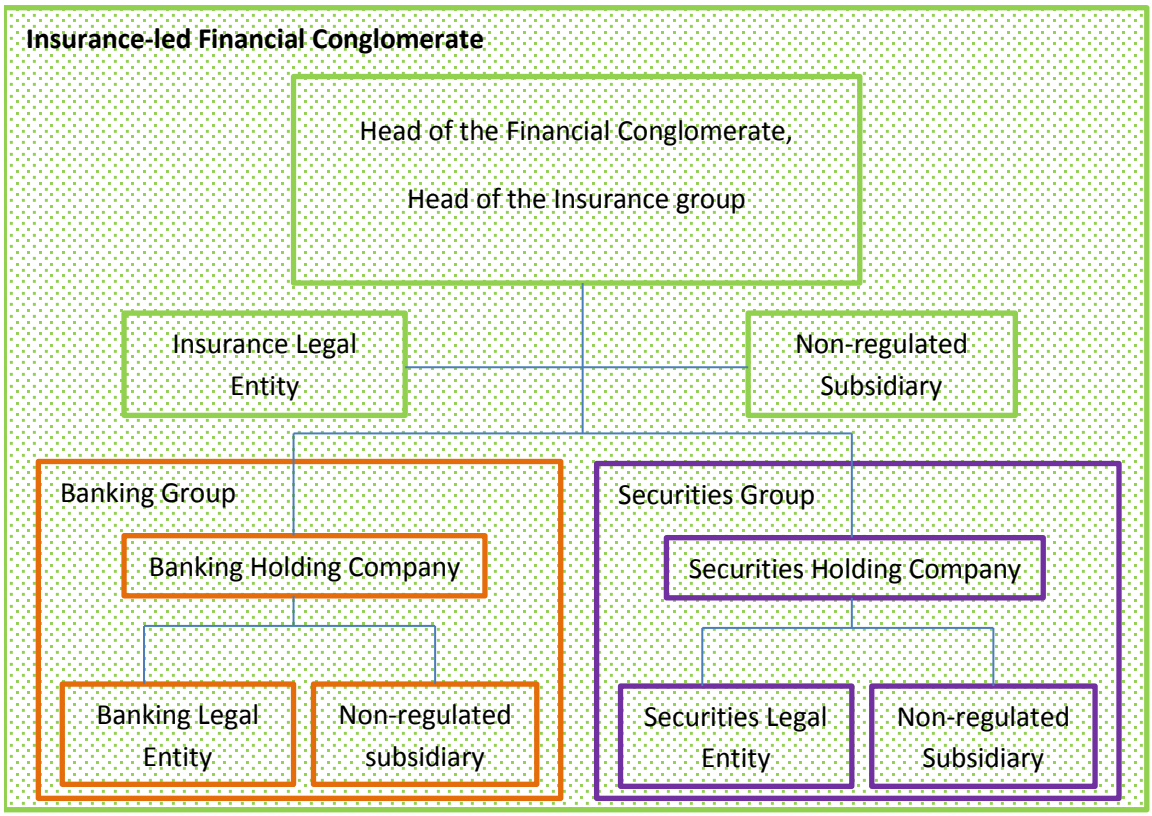
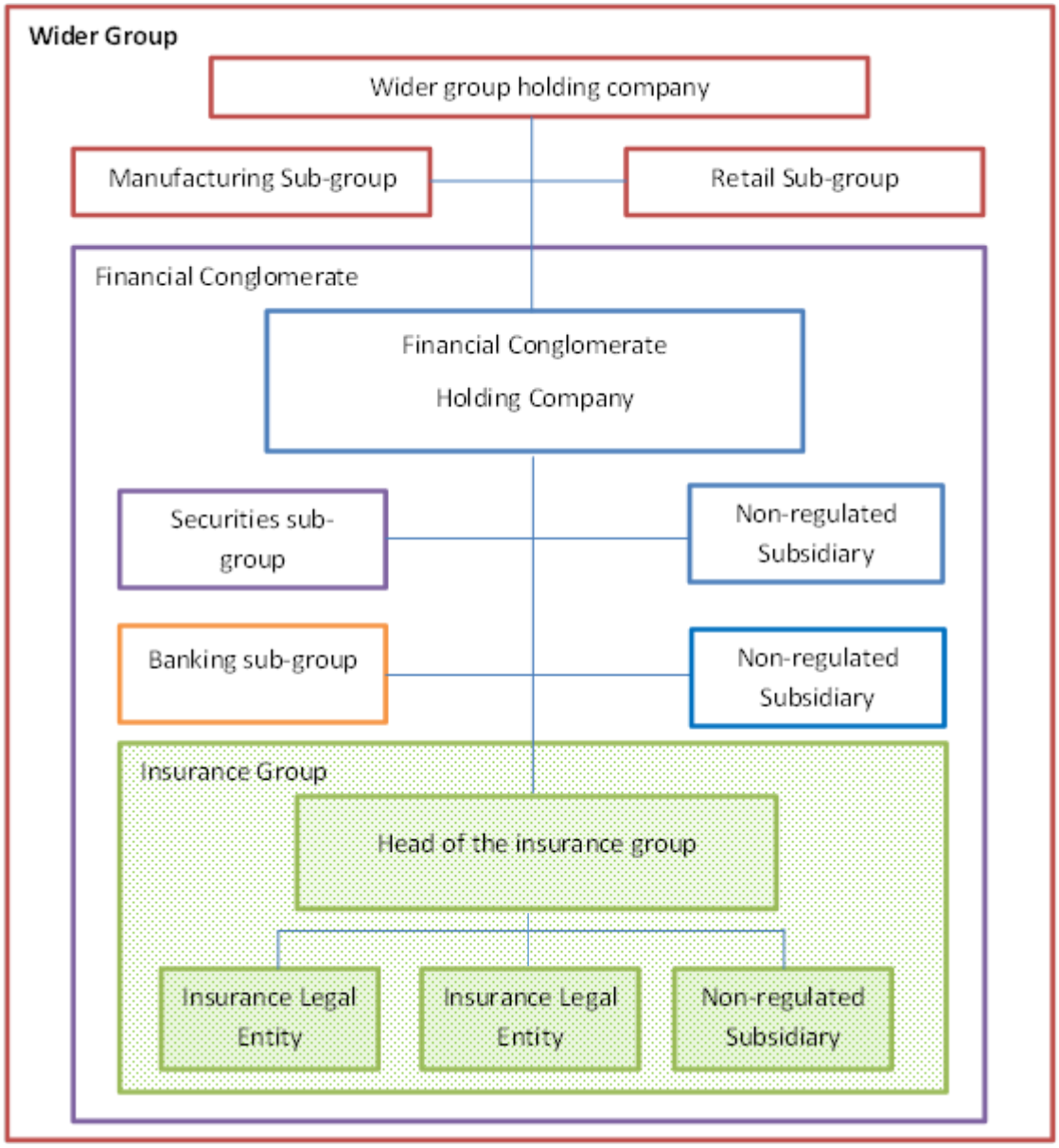


Figure 23.4 Wider group



ICP 24 Macroprudential Surveillance and Insurance Supervision

The supervisor identifies, monitors and analyses market and financial developments and other environmental factors that may impact insurers and insurance markets and uses this information in the supervision of individual insurers. Such tasks should, where appropriate, utilise information from, and insights gained by, other national authorities.

24.1 The supervisor identifies underlying trends within the insurance sector by collecting data on, but not limited to, profitability, capital position, liabilities, assets and underwriting, to the extent that it has information available at the level of legal entities and groups. The supervisor also develops and applies appropriate tools that take into account the nature, scale and complexity of insurers, as well as non-core activities of insurance groups, to limit significant systemic risk.

24.1.1 The supervisor should identify macroeconomic factors such as, but not limited to, level of interest rates, financial market indices, inflation, interconnectedness with other financial market participants, catastrophes and pandemics that may impact insurers and insurance markets. The supervisor should have processes in place to conduct regular market analyses. This enables the supervisor to be aware of material changes in market conditions that may impact individual insurers, the whole insurance sector, and other financial sectors.

24.2 The supervisor, in performing market analysis, considers not only past developments and the present situation, but also trends, potential risks and plausible unfavourable future scenarios with the objective and capacity to take action at an early stage, if required.

24.2.1 Macroprudential surveillance is defined as a set of systems and processes that monitors the vulnerability of the financial system with respect to economic and financial shocks. One of the aims of macroprudential surveillance and regulation is to:

- Identify systemic risk (including shocks, interconnectedness and feedback effects);
- Reduce the likelihood of systemic risk; and
- Mitigate spillover effects within the financial system and into the real economy.

24.2.2 The supervisor should design macroprudential surveillance approaches from a multi-disciplinary and cross-sectoral perspective to identify trends and developments that might negatively impact the risk profile of insurers. It should consult and coordinate with all relevant stakeholders, including public and private sector organisations.

24.2.3 The supervisor should identify the key sources of market and industry information, have a regular communication strategy in place with respect to those sources and take into account all relevant factors when assessing that information. The supervisor should ensure that it has an appropriate internal focus on regularly reviewing macroprudential

surveillance issues and, where appropriate, initiates senior level communication with insurers on these issues.

24.3 The supervisor performs both quantitative and qualitative analysis and makes use of both public and other sources of information, including horizontal reviews of insurers and relevant data aggregation.

24.3.1 A horizontal review is one that is performed across many insurers around a common subject with the goal of revealing the range of practice among the insurers. There are two objectives of such horizontal analysis. First, an insurer-by-insurer review should provide a relative ranking to determine which insurers are outliers, whether to bring those insurers back in line with their peers, and, if so, what areas need to be addressed. The second and less often used objective is to determine whether the industry practice as a whole is strong enough to address the risks embedded in the activity.

24.3.2 To make horizontal reviews effective, the following parameters need to be taken into account:

- Where peer groups are utilised, the choice of the peer group can have an impact on the quality of the outcome of the review. The supervisors should carefully consider the criteria for inclusion in the peer group.
- The sequential execution of reviews over a long period of time reduces the effectiveness of horizontal, or peer, comparison. Reviews should be performed within as short a period of time as practical.
- When reviewing internationally active insurance groups, the group-wide supervisor should seek out a global perspective. This global perspective can come from a peer authority or a third party (including international financial institutions such as, but not limited to, the IAIS, IMF and World Bank) which might have a broader perspective on the state of global practice.
- The supervisor should have an established communication strategy in place for horizontal reviews, which addresses the need for assessments to go to the insurer's Board and to Senior Management. Where appropriate, some higher level aggregated peer group information may be provided to insurers, who may or may not have participated in the review, so that they can gain from the lessons learned.
- The results of horizontal reviews performed within a single jurisdiction can be beneficial to the global supervisory community as a whole, especially as it may relate to systemic risk to the insurance sector. The supervisor may also consider suitable forums for the communication of information that is not necessarily insurance or firm specific.
- Horizontal reviews need not always be sizeable undertakings. Simple horizontal outlier analysis on readily available insurer reports can often provide helpful supervisory insight. Simple analysis of some of these reports, including trends and peer

comparisons, can help the supervisor to identify areas of potential risk and help it to better target future work.

24.3.3 The supervisor should evaluate its data needs and data processing capabilities in order to determine whether it is able to accommodate additional requirements arising from the supervision of more complex insurers, such as internationally active insurance groups. Deficiencies in:

- the type of data collected;
- the supervisor's ability to process the data in a timely and complete way; or
- its ability to collect ad-hoc data in a timely manner

should be addressed as soon as possible.

24.4 The supervisor uses market-wide data to analyse and monitor the actual or potential impact on the financial stability of insurance markets in general and of insurers in particular and takes appropriate action. The supervisor also makes sufficiently detailed aggregated market data publicly available.

24.4.1 Insofar as international relationships affect the supervisor's internal insurance and financial markets, the analysis is not limited to domestic markets, but includes also regional and/or global developments.

24.4.2 It is the supervisor's responsibility to ensure access to sufficiently detailed aggregated market data either by publishing data itself or by providing others with adequate means for publishing required data. This could be achieved by engaging a government statistical office or cooperating with the local insurance sector, provided the supervisor is satisfied with content, frequency and timeliness of such data publication.

24.5 The supervisor assesses the extent to which macro-economic vulnerabilities and financial market risks impinge on prudential safeguards or the financial stability of the insurance sector.

24.5.1 Supervisors should monitor insurers' connections with financial markets and the real economy in order to obtain early identification of potential or existing build-up of risks in other sectors that could adversely impact the insurance sector.

24.5.2 When necessary, the supervisor cooperates with other financial market supervisors (such as banking, securities and pension supervisors, central banks and government ministries). For additional information on supervisory cooperation, refer to ICP 25 Supervisory Cooperation and Coordination.

24.6 The supervisor has an established process to assess the potential systemic importance of insurers, including policies they underwrite and instruments they issue in traditional and non-traditional lines of business.

24.6.1 In assessing the systemic importance of insurers, the supervisor should deploy processes with adequate depth and quality to support effective supervision given the nature, scale and complexity of the supervised entities and taking into account the results of market analysis and macroprudential surveillance.

24.7 If the supervisor identifies an insurer as systemically important, it develops an appropriate supervisory response, which is commensurate with the nature and degree of the risk.

ICP 25 Supervisory Cooperation and Coordination [88]

The supervisor cooperates and coordinates with other relevant supervisors and authorities subject to confidentiality requirements.

25.1 The supervisor takes steps to put in place adequate coordination arrangements with involved supervisors on cross-border issues on a legal entity and a group-wide basis in order to facilitate the comprehensive oversight of these legal entities and groups. Insurance supervisors cooperate and coordinate with relevant supervisors from other sectors, as well as with central banks and government ministries.

25.1.1 The main benefits of increased coordination and cooperation among involved supervisors are:

- It facilitates all involved supervisors in holistically reviewing international groups through regular face-to-face discussions and other processes;
- It provides an efficient platform for information sharing across the group and for contribution of involved supervisors to group-wide decisions;
- Broader exposure and greater influence for involved supervisors in examining group-wide situations than would be the case under legal entity reviews;
- It facilitates comparison of supervisory methodologies and assumptions across the group;
- Ability to share the application of group-wide methodologies and assumptions among involved supervisors; and
- It facilitates the application of coordinated decisions when appropriate.

25.1.2 There are various mechanisms for fostering cooperation, promoting communication and information exchange and facilitating enhanced coordination of group-wide supervision. The benefits of designating a group-wide supervisor can be further enhanced through mechanisms such as a memorandum of understanding (MoU) between involved supervisors and establishment of a "supervisory college" of involved supervisors. In fact the work of a supervisory college is usually based on the conclusion of a MoU between all parties involved.

25.1.3 Coordination arrangements may include supervisory recognition of involved supervisors and how their various supervisory roles interrelate within group-wide supervision.

25.1.4 Coordination arrangements for group-wide supervision include supervisory colleges and/or other coordination mechanisms intended to foster cooperation, promote common understanding, communication and

[88] Amended November 2015

information exchange, and facilitate enhanced coordination for group-wide supervision. These arrangements are organised in accordance with the nature, scale and complexity of the group and of the risks the group poses to supervisory objectives and are commensurate with the legal and organisational structure and business activities of the group. They also have due regard to the legislative frameworks applicable and authorities of the various supervisors involved.

25.1.5 Coordination mechanisms provide added value in terms of prudential supervision of the group. The arrangement enhances the quality of supervision of legal entities within the group.

25.1.6 Supervisory colleges and other coordination mechanisms should be established on the basis of common agreements of all involved supervisors, taking into consideration the nature, scale and complexity of the group including its legal and organisational structure and business activities of the group and the risks the group poses to supervisory objectives.

Memorandum of Understanding (MoU)

25.1.7 An MoU could take the form of a bilateral (between two jurisdictions) or multilateral (between more than two jurisdictions) agreement. The scope of an MoU could also vary, to reflect the circumstances of the particular group and involved supervisors. An MoU may relate to the exchange of information, based on formal request and/or in particular circumstances, such as emergency circumstances. In order for an MoU to work effectively, it is important that a strict confidentiality regime is ensured among all involved jurisdictions.

25.1.8 An MoU may extend to the allocation of identified aspects of group-wide assessment to particular involved supervisors or the allocation of all aspects of group-wide assessment to the designated group-wide supervisor. An MoU may indicate a level of accepted reliance by one supervisor on the work of another supervisor (a limited form of supervisory recognition). Such an arrangement may be an initial stage in the negotiation of a more formal supervisory recognition arrangement, as the level of cooperation and trust between involved supervisors grows. (Refer to ICP 13 Reinsurance and Other Forms of Risk Transfer, and Guidance 25.1.15 to 25.1.71 on criteria for supervisory recognition in group-wide supervision.) In particular, an MoU may indicate a level of accepted reliance on the part of other involved supervisors on the work of the group-wide supervisor. Such an arrangement contributes to the objectives of streamlined group-wide supervision and avoidance of unwarranted supervisory duplication.

Supervisory college

25.1.9 A mechanism for coordination of activities and cooperation among involved supervisors is through the establishment of a supervisory college. A supervisory college could take various forms, depending on the structure and organisation of the group, the activities of the group and the jurisdictions involved in its supervision.

25.1.10 Members of the supervisory college would comprise supervisors involved in the supervision of insurers which are part of the group. Where relevant, other sector supervisors could be invited.

25.1.11 Where designated, the group-wide supervisor would normally act as the chair or key coordinator of the supervisory college. The group-wide supervisor could be responsible for initiating a supervisory college, inviting the involved supervisors to be members and arranging supervisory college meetings. Members of the supervisory college could agree on procedures for the allocation of responsibilities among the group-wide supervisor and other involved supervisors in relation to group-wide supervision.

25.1.12 Through regular supervisory college meetings, greater interaction and exchange of relevant information among involved supervisors can be facilitated. The supervisory college also provides an opportunity for supervisors from different jurisdictions to meet and build contacts that might not otherwise be readily available. In times of stress, when the effectiveness of supervisory collaboration is most likely to be tested, the contacts that have been built through participation in a supervisory college may be of great benefit.

25.1.13 The primary purpose of a supervisory college would be to discuss supervisory issues and exchange information that is relevant to a group. Typically a supervisory college would focus on the following:

- Agree on the cooperation and coordination process including the planning and setting of procedures for supervisory cooperation during emergency situations;
- Produce an overview of the group setting out its formal and operational structure;
- Carry out a risk analysis on a group-wide basis, identifying the most relevant entities and the most important relationships in the group;
- Discuss issues supervisors have found within the entities they supervise that they believe could be systemic throughout the group;
- Where practicable, agree on areas of supervisory work to avoid unnecessary duplication; possible joint inspections could also be decided;
- Agree on the information supervisors should gather from the group and exchange with other members of the supervisory college, including the form and the frequency with which this happens; and
- Agree on whether the supervisory college should set out any arrangements in respect of group-wide supervision in written form (bilateral or multilateral agreements).

25.1.14 On request, the members of a supervisory college should communicate to one another all relevant information which may allow or facilitate supervision on a group-wide basis. Members of a supervisory college

should also consider whether to communicate, on their own initiative, information which appears to be essential for other involved supervisors. The information that can be exchanged is facilitated by cooperation agreements concluded between the involved supervisors, including for instance whether the supervisors involved in the supervisory college have signed the IAIS Multilateral MoU (MMoU).

Guidance on criteria for supervisory recognition in group-wide supervision

25.1.15 Guidance 25.1.15 to 25.1.71 are collectively called *Guidance on criteria for supervisory recognition in group-wide supervision* and they are meant to support ICP 25 Supervisory Cooperation and Coordination directly. Supervisory recognition is a tool that can be used to enhance cross-border cooperation and coordination. The guidance presents criteria that insurance supervisors can use to assess the extent to which another supervisory regime can be recognised and relied upon for the purpose of group-wide supervision. Supervisory recognition could also be relevant for the supervision of insurance legal entities.

25.1.16 In providing guidance on criteria for supervisory recognition in group-wide supervision, it is not the intention to lessen the importance of legal entity supervision or to replace the role of the legal entity supervisor in respect of insurers within its jurisdiction. Nor is it the intention of this guidance to imply that supervisory recognition is compulsory.

25.1.17 This guidance does not modify or supersede any legal or regulatory requirements in force in, or applying to, the respective jurisdictions of involved supervisors.

25.1.18 This guidance considers the approaches by which an insurance supervisor could assess the extent to which to recognise another supervisory regime and consequently, the level of reliance that could be placed on the other supervisor. It is not the intention of this guidance to prescribe one specific approach, as the form of recognition and the criteria used for assessment will vary depending on its purpose.

Basis of supervisory recognition

25.1.19 A key element of assessment and recognition is that the regime being assessed can, at a minimum, demonstrate compliance with relevant IAIS ICPs and standards. However, this does not exclude the possibility of an assessment of equivalence with the assessor's own regime.

25.1.20 When establishing the recognition of another jurisdiction's supervisory regime, analysis should focus more on the outcomes that are achieved, than on the process to achieve them.

25.1.21 Supervisory recognition is not designed to necessarily grant an open passport for any insurance company from the recognised jurisdiction to establish an operation or activity in the assessing jurisdiction. Depending on the purpose of the recognition, and the level of reliance and cooperation between the parties, recognition might allow certain types of insurance activity or products, but not others, or allow a limited threshold of activity.

25.1.22 The different perspectives (and any different issues to take into account) of home-host supervisors should be considered - a home supervisor would be concerned with assessing whether to recognise the supervision of host supervisors of entities within the group; while a host supervisor would be concerned with assessing whether to recognise the supervision of the home supervisor as group-wide supervisor.

25.1.23 Also, it should not be assumed that once recognition has been achieved that reliance can be automatically continued without further review. Recurring review, in respect of the jurisdiction or on an individual case basis, may be required.

25.1.24 Again, it should not be assumed that once recognition, and even a degree of reliance, has been achieved there can be an automatic delegation of tasks. If supervisory recognition is achieved, the supervisor may decide to delegate certain tasks but not its responsibilities.

25.1.25 Supervisory recognition can be achieved through unilateral, bilateral or multilateral agreement.

- Unilateral recognition refers to a situation where a supervisor recognises the supervision exercised by another, without requiring that the latter recognise the supervision exercised by the former.
- Bilateral recognition refers to a situation where two supervisors recognise each other's supervision.
- Multilateral recognition refers to a situation where several supervisors (3 or more) recognise the supervision exercised by the others.

Objective and purpose of supervisory recognition

25.1.26 The primary purpose of making an assessment for supervisory recognition is to provide insurance supervisors with sufficient confidence that the corresponding supervisory regimes have the necessary regulatory and supervisory framework, as well as sufficient quality of resource and expertise, to achieve supervisory outcomes at an acceptable level in order for them to place reliance on one another if required.

25.1.27 Effective supervisory recognition should assist in reducing redundancy of work in cross-border supervision of insurance groups. The supervisory recognition approach should be organised in a manner that minimises unwarranted duplication of regulatory and supervisory requirements to the extent possible, thereby reducing burdens on both supervisors and insurance groups alike.

25.1.28 Supervisory recognition between jurisdictions may also assist in greater consistency in the approaches taken by each jurisdiction, thus removing the potential for gaps and misunderstandings between jurisdictions.

25.1.29 Supervisors looking to recognise another supervisory regime should carry out an assessment of the acceptability of the counterpart's regime based on the specific level or objective of supervisory recognition sought.

25.1.30 The form of supervisory recognition sought will vary according to the outcomes that are expected and should therefore be aligned accordingly.

25.1.31 Types of recognition along with illustrations that may assist in their consideration could include:

- An elementary form of supervisory recognition focused primarily on fostering the exchange of information and thereby providing the ability to rely sufficiently on the information being exchanged. Examples may include memorandum of understanding (MoU) or multilateral memorandum of understanding (MMoU).
- Recognition of host supervisors by the home supervisor. For the supervision of insurance legal entities, this degree of supervisory recognition would identify the degree of reliance by a home supervisor on the supervision of affiliates in another jurisdiction. Successful supervisory recognition of host supervisors may provide the home supervisor with sufficient confidence in the supervision conducted at an insurance legal entity level, reducing redundancy of processes and operations by the involved jurisdictions and a lower burden on the insurance group. This may include a wide range of qualitative and quantitative requirements, such as suitability of persons, or solvency assessments.
- Recognition of the home supervisor by host supervisors. For group-wide supervision, this degree of supervisory recognition would identify the ability of the host supervisor to rely on the home supervisor at the insurance group level. For example, this would enable the host supervisor to rely on the qualitative and quantitative assessments made by the home supervisor at the level of the insurance group. Effective supervisory recognition here could assist the host supervisor in deciding whether the level of capital held in the insurance legal entity is sufficient for their local requirements.
- For supervision at the level of a financial conglomerate, supervisory recognition would be expected to follow that of group-wide supervision but extend even further to allow for the recognition of cross-sector authorities that perform oversight on non-insurance activities of the financial conglomerate in question. Supervisory recognition in this form should assist insurance supervisors in appreciating further cross-sectoral issues and risks as well as gaining comfort from the abilities of supervisors from the other financial sectors. In turn, when mapping against the scope of group-wide supervision in its own jurisdiction, an insurance supervisor may gain greater awareness of the appropriateness of this scope.

25.1.32 It would also be possible for one jurisdiction to fully recognise another supervisory regime. This could extend insofar that authorisation is granted by which the insurer from another jurisdiction is able to operate in the local jurisdiction with reduced local supervision. This does not

remove the obligation on insurers to continue to meet local regulatory requirements such as market conduct rules.

25.1.33 The above classifications of levels in which recognition may be applied are by no means limited and other variations may be appropriate, subject to the individual needs of the jurisdictions seeking to identify and apply supervisory recognition.

Criteria for supervisory recognition

25.1.34 The assessment of another supervisory regime should seek to establish the acceptability of that regime by an analysis of the outcomes it achieves and not necessarily by an analysis of the process by which it achieves them.

25.1.35 The expected outcomes will vary according to the level of supervisory recognition sought and should therefore be aligned accordingly.

25.1.36 Assessment should not only cover the regulatory and/or supervisory framework but also cover supervisory practice.

25.1.37 The other supervisory regime should be able to demonstrate appropriate adherence to the relevant IAIS ICPs and standards. Supervisors should also take into consideration adherence with, and relevance of, other legal statutes.

25.1.38 While the precise form of a supervisory recognition assessment is a matter of individual jurisdictional discretion, supervisors should take into account the criteria described in the following paragraphs.

Criteria for supervisory recognition - pre-requisites

25.1.39 The supervisor should assess certain pre-requisites that might be considered mandatory requirements to be met before continuing with further assessment of other criteria.

25.1.40 Pre-requisite conditions include the other supervisory regime's legal framework and the application of supervisory powers and resources.

25.1.41 The supervisor may look to verify that the other supervisory regime has:

- a sound legal basis and transparent legal regime that clearly specifies appropriate supervisory responsibilities and powers, including enforcement powers;
- appropriate protection for the supervisor against liability arising from actions within its mandate;
- freedom from any undue political, governmental and industry interference in the performance of supervisory responsibilities;
- adequate number and quality of resources; and
- the ability to perform suitability assessments at insurance legal entity and insurance group (on both a national and cross-border) level.

25.1.42 Upon satisfactory review of the pre-requisites, further assessment of additional elements may need to be considered depending upon the outcomes sought. These could include:

- Licensing requirements
- Regulatory requirements
- Intervention and enforcement powers of supervisor
- Winding-up requirements
- Supervisory cooperation and exchange of information requirements.

Criteria for supervisory recognition - licensing requirements

25.1.43 The other supervisory regime should be able to demonstrate:

- the necessary regulatory requirements to ensure the insurer meets basic standards, both prior to licensing and on a continuous basis including the ability to supervise the suitability of persons, adequacy of internal control and risk management systems as well as the robustness of accounting and audit frameworks; and
- sufficient powers over licensing to either refuse or withdraw the licence on appropriate grounds (including as result of shareholder requirements or when close links may impede supervision).

Criteria for supervisory recognition - regulatory requirements

25.1.44 The other supervisory regime has the ability:

- to sufficiently identify the adequacy of capital and put in place requirements on investments; and
- to verify the state of solvency of the insurer, the effectiveness and properness of administrative and accounting procedures and the appropriateness of the internal controls including risk management and governance.

Criteria for supervisory recognition - intervention and enforcement powers of supervisor

25.1.45 The other supervisory regime has sufficient powers to pursue enforcement, if necessary, and:

- is able to ensure the adherence with laws, regulations and administrative provisions through enforcement action if required;
- in the event of non-compliance with legal provisions can impose measures to prevent further infringements from occurring; and
- is able to cooperate with other relevant authorities when taking enforcement actions.

Criteria for supervisory recognition - winding-up requirements

25.1.46 For insurers that are experiencing difficulties, the other supervisory regime is able to take appropriate measures, including imposing requirements that will lead to an orderly winding-up to protect policyholders in an appropriate manner. These measures may include:

- prohibition of the disposal of assets
- implementation of a recovery plan
- withdrawal of authorisation
- imposition of actions directly on individual directors, managers or controllers.

Criteria for supervisory recognition - supervisory cooperation and exchange of information requirements

25.1.47 The other supervisor should have the ability to enter into confidentiality and information sharing agreements and observe the appropriate treatment of confidential information; and identify the terms of any existing memorandum of understanding (MoU) or multilateral memorandum of understanding (MMoU).

25.1.48 The other supervisor should be able to ensure secure communication channels exist and jurisdictional confidentiality rules are respected.

25.1.49 The other supervisor should be able to demonstrate that it is able to obtain a sufficient degree of information in a timely fashion from its insurers in order to exercise effective supervision. This may be at both the insurance legal entity and insurance group (cross-border) level.

Process for establishing supervisory recognition - basis for undertaking assessment

25.1.50 The first stage of establishing supervisory recognition involves confirmation of the underlying rationale for the assessment and the form and purpose of supervisory recognition. In particular the supervisor undertaking the assessment needs to be identified as does the supervisory regime being assessed. If recognition is only being considered for part of a supervisory regime, the part being assessed needs to be confirmed and documented.

25.1.51 The reason or reasons for undertaking the assessment should be agreed between the parties concerned and documented.

Process for establishing supervisory recognition - identification of existing agreements

25.1.52 Before undertaking the assessment, any existing agreements which may influence the outcome of the assessment should be identified. These may include an existing bilateral MoU between the jurisdiction being assessed and the assessor and whether either party is a signatory to a relevant MMoU.

25.1.53 The existence of any other formal or informal unilateral agreements to exchange information should be identified together with any special conditions that may be attached to such an agreement.

25.1.54 The existence of any supervisory recognition agreements in place between the jurisdiction being assessed and any other jurisdictions should be noted.

Process for establishing supervisory recognition - other information

25.1.55 Any other relevant background information should be obtained, for example whether the jurisdiction has been subject to an IMF FSAP or other assessment, including a self-assessment. If there has been an IMF FSAP, details of the assessment report should be obtained and analysed.

25.1.56 Other background information could include the existence of recognition agreements with other jurisdictions, such as for part or all of the supervisory regimes of the European Union.

Process for establishing supervisory recognition - obtaining information

25.1.57 Prior to undertaking the assessment, information regarding the regulatory and supervisory frameworks should be obtained regarding the supervisory regime being assessed. This can be obtained directly from the other supervisor or through other sources.

25.1.58 Information can also be obtained through carrying out visits to the other supervisor's jurisdiction and talking to the supervisory authorities and other relevant parties.

25.1.59 Consideration should be given to any need to verify the information obtained.

Process for establishing supervisory recognition - carrying out the assessment

25.1.60 The next stage of assessing the supervisory regime is to consider the relevant assessment criteria by specifying the specific areas to be assessed. Once the areas are confirmed, the assessment can be carried out against the criteria and fully documented.

25.1.61 Consideration ought to be given to a quality check on the assessment, ideally by persons who are independent from the assessors who carried out the initial assessment.

25.1.62 Once the assessment is complete a decision has to be made as to whether or not to recognise the supervisory regime in the jurisdiction being assessed. The decision should ideally be based on a pre-determined set of rules, such as meeting the required criteria in all cases or a certain percentage of cases. It may also be acceptable for some of the criteria to be partially satisfied.

25.1.63 It may be necessary to apply subjective judgment in determining whether or not a jurisdiction should be recognised, particularly if some criteria are deemed to carry more weight than others.

Process for establishing supervisory recognition - due process and communicating the decision

25.1.64 Feedback should be provided to the supervisory regime being assessed during the assessment process and an opportunity should be provided for the supervisor to provide additional clarification. Supervisors should resolve any differences between them in an efficient way.

25.1.65 When the assessment has been finalised, the decision as to whether the supervisory regime should be recognised should be communicated. If recognition is not possible, the areas where the criteria were not met should be communicated. In the case of an adverse decision the jurisdiction being assessed should be given the opportunity to explain how it may meet the criteria in future. A process for reassessment could then be established.

Process for establishing supervisory recognition - format of recognition agreements

25.1.66 A formal agreement is not a pre-requisite to any form of supervisory recognition, but written agreements have a number of benefits, including clarification of terms and obligations and facilitating cooperation between jurisdictions. If a written agreement is entered into, the following points may be considered.

25.1.67 The agreement should set out the commencement date and specify the roles and responsibilities of the respective parties. If the agreement is for a finite term, the end date of the recognition agreement should be specified together with details of the process for renewal which may involve reassessment.

25.1.68 The agreement should contain a confidentiality agreement between the respective parties together with requirements for the provision of information.

25.1.69 The agreement should include provisions for the respective parties to regularly exchange information in respect of changes to their regulatory regime.

25.1.70 The agreement may include details of the process for resolving disputes, for example in the case of a refusal to respond to a valid request for information.

25.1.71 The parties should consider whether and to what extent details of any agreement in respect of supervisory recognition ought be publicised.

25.2 Coordination agreements include establishing effective procedures for:

- **information flows between involved supervisors;**
- **communication with the head of the group;**
- **convening periodic meetings of involved supervisors; and**
- **conduct of a comprehensive assessment of the group.**

25.3 Supervisors cooperate and coordinate in the supervision of an insurance legal entity with a branch in another jurisdiction in accordance with their authorities and powers.

25.4 Supervisors cooperate and coordinate in the supervision of insurance groups and insurance legal entities that are parts of insurance groups in accordance with their authorities and powers.

25.5 Supervisors establish a process to identify a Group-wide supervisor for all cross-border insurance groups.

Identification of a group-wide supervisor

25.5.1 A group-wide supervisor would ultimately be responsible for ensuring effective and efficient group-wide supervision. The group-wide supervisor should coordinate and disseminate essential information needed for reviewing and evaluating risks and assessing solvency on a group-wide basis. If a group-wide supervisor is to achieve this, there needs to be open and constructive relationships among the involved supervisors. Therefore, there needs to be coordination of, and collaboration by, supervisors to avoid unnecessary duplication.

25.5.2 Experience has shown that it is generally clear who should take the role of group-wide supervisor for a particular group. However, depending on the structure of a particular group, the case may arise where several supervisors fulfil the conditions to be considered as a group-wide supervisor. In such cases it is necessary to have a clear and transparent process for identifying and agreeing an appropriate group-wide supervisor.

25.5.3 In some jurisdictions, the legal or regulatory system may include provisions which allow or require the designation of a group-wide supervisor. However, this formal designation may not be recognised in all jurisdictions in which a particular group operates. The absence of a formal mechanism should not limit the extension of the group-wide supervisor to those other jurisdictions, on a de facto basis, given the agreement and cooperation of the involved supervisors.

25.5.4 In principle the home supervisor of the head of the group should be first considered to take the role of the group-wide supervisor.

Other factors to consider in determining the group-wide supervisor would include, but are not limited to:

- the location of the group's head office, given that this is where the group's Board and Senior Management is most likely to meet, and ready access of the group-wide supervisor to the group's Board and Senior Management is an important factor; and
- where the registered head office is not the operational head of the group, the location where:
  - the main business activities of the group are undertaken; and/or
  - the main business decisions are taken; and/or
  - the main risks are underwritten; and/or
  - the group has its largest balance sheet total.

25.5.5 Ultimately the involved supervisors would be expected to determine the need for a group-wide supervisor and agree the supervisor to take that role. The emphasis should be on a joint decision between all involved supervisors to reach an acceptable outcome.

25.5.6 However, regardless of the approach in the jurisdiction of the group-wide supervisor, this formal designation may not be recognised in all jurisdictions in which a particular group operates and reliance is placed on non legislative means - through agreements and/or other coordination activity among the involved supervisors.

25.5.7 At present, it is not generally possible to consider or establish international legislation which grants legal power and authority to a group-wide supervisor across jurisdictional borders. It is important, therefore, that there are clear agreements (formal or otherwise) between all involved supervisors in order to allow the group-wide supervisor to fulfil its tasks and to ensure support from involved supervisors.

25.6 The designated group-wide supervisor takes responsibility for initiating discussions on suitable coordination arrangements, including establishing a supervisory college, and acts as the key coordinator or chairman of the supervisory college, where it is established. Other involved supervisors participate with the Group-wide supervisor in coordination discussions and in the supervisory college.

25.6.1 The tasks of the group-wide supervisor would be expected to include the assessment of:

- group structure and interrelationships, including ownership and management structure;
- capital adequacy at group level including approval of the use of a group-wide internal model for group-wide regulatory capital purposes (where applicable);
- reinsurance and other forms of risk transfer from the group and risk concentration;
- the group's own risk and solvency assessment;
- intra-group transactions and exposures, including intra-group guarantees and possible legal liabilities and any other capital or risk transfer instruments; and
- internal control mechanisms and risk management processes, including reporting lines and fit-and-proper assessment of the Board, Senior Management as well as the propriety of significant owners.

Interrelationship between group-wide supervisor and supervisory college

25.6.2 The operational effectiveness of a group-wide supervisor may be enhanced considerably through the establishment of a supervisory college as a mechanism for enhancing cooperation and information exchange among involved supervisors. Also, effectiveness and efficiency of the supervisory college may be improved further through awareness

and understanding of the quality of relationship possible between the group-wide supervisor and other members.

25.6.3 The group-wide supervisor is expected to take an important role in a number of areas in the operation of a supervisory college. These can be summarised as follows:

- initiating the establishment of a supervisory college;
- clarifying the membership/participation of involved supervisors in the supervisory college, including considering the establishment of subgroup colleges to enhance the overall effectiveness of the college;
- clarifying the functions of the supervisory college and the role of involved supervisors, including of the group-wide supervisor, which may be formalised in a terms of reference;
- coordinating the ongoing activities of the supervisory college, including planning meetings, supervisory activities, processes of information exchange; and
- establishing a crisis management plan.

25.6.4 In all of these areas, while the group-wide supervisor would be expected to take the initiative as the coordinator or chair of the supervisory college, the group-wide supervisor should necessarily work in collaboration with involved supervisors and seek, to the extent possible, agreement among involved supervisors. In this respect, establishing early agreement and clarity of understanding on the operational aspects of the college will contribute to establishing good relationships among the involved supervisors from the commencement.

25.6.5 An important role of the group-wide supervisor will be the continued management of these relationships with and among supervisory college members. The group-wide supervisor should be mindful of the expectations of involved supervisors from the supervisory college and their expectations of the role of the group-wide supervisor. Awareness of these expectations could play a pivotal role, especially in times of a crisis. This awareness should also include legal and internationally relevant facts and relationships, which may be critical to the supervisory actions taken in particular circumstances including crisis.

25.6.6 An efficient and harmonious relationship may only be possible when a mutual respect and trust is established and observed among involved supervisors. The group-wide supervisor should regularly consider opportunities to improve relationships and to reinforce mutual trust.

25.6.7 Access to relevant information for involved supervisors will be one important measure of the effectiveness of the supervisory college. While the group-wide supervisor will have a clear role in the gathering of relevant information, an equally important consideration will be the appropriate and timely dissemination of that information consistent with applicable confidentiality requirements. Interim information that has been received and may be of importance to the supervisory work of the other involved supervisors should be made available to those supervisors. This

will encourage mutual trust, sharing of information, and further collaboration and cooperation among all involved supervisors.

25.6.8 While the management of internal relationships is important, the group-wide supervisor should also play a role in establishing appropriate contacts with other associated participants who may be of assistance to the supervisory college, for example other sector participants in the case of a financial conglomerate. When identifying such participants the group-wide supervisor should take into consideration the impact and/or influence that they may have on the existing relationship between college members and should weigh these issues against the value of information and wealth of experience these additional members may be able to provide.

Coordination and chairmanship

25.6.9 There may be various circumstances in which the establishment of a supervisory college is initiated, and depending on purpose and membership, various ways in which the roles of involved supervisors – including chairmanship – are determined. In general, the group-wide supervisor, where designated, would be expected to take the responsibility for initiating a supervisory college and to act as the key coordinator or chairman of the supervisory college, to the extent practicable.

25.6.10 A supervisory college is expected to meet on a regular basis appropriate to the nature, scale and complexity of the group. In the case of a group which is relevant to overall financial stability, the supervisory college should meet at least annually to be most effective. The chairman should ensure the prerequisites for the effective operation of a supervisory college exist, such as coordinating meeting schedules, confidentiality agreements, etc.

25.6.11 The chairman should propose the agenda for supervisory college meetings, but should incorporate the views and opinions of other members. The agenda may be set to discuss specific issues or wide ranging issues depending on what is happening globally and/or in respect of a particular group.

25.6.12 Supervisory college meetings should be planned with clarity of the outcomes that are being sought and, based on this, should clearly record the outcomes that are achieved, including :

- action points arising from any meeting(s);
- the individual(s) to whom a task has been assigned; and
- the deadline when an action should be complete.

It will be the responsibility of the supervisory college to track individual items to make sure that the necessary action has been carried out.

25.7 There is appropriate flexibility in the establishment of a supervisory college – both when to establish and the form of its establishment – and other coordination mechanisms to reflect their particular role and functions.

Whether and when to establish a supervisory college

25.7.1 Supervisory colleges, where established, can be structured in different ways. They should, however, be operated in such a way that allows members of the college to fully understand the major risks to which the group is subject.

25.7.2 There is a high level of divergence in the insurance industry regarding the nature of organisations, the nature of regulation and supervision, and the development of markets and supervisory regimes in different jurisdictions. While enhanced convergence of supervisory practice is expected over time, there is currently a need for flexibility in the considerations of both whether, and when, to establish a supervisory college.

25.7.3 As a general premise, the establishment of a supervisory college should be considered where it is necessary to improve the effectiveness and efficiency of supervision – for example, when significant cross-border activities and/or intra-group transactions are conducted; where effective group-wide supervision is essential to the protection of policyholders; and/or where effective group-wide supervision is essential to the financial stability of the financial market as a whole.

25.7.4 Consideration should be given to the circumstances and/or other factors that could be considered in determining whether and when to establish a supervisory college. Also the principle of materiality and proportionality should be applied in this determination. Further, a jurisdiction may determine that there are particular circumstances or minimum criteria which suggest that the establishment of a supervisory college should be a requirement.

25.7.5 The factors which are relevant in this context include the following (it is noted that these factors are also relevant to considerations on the form and operational structure of a supervisory college):

- Relevance of the group to overall financial stability
  - where effective group-wide supervision of a particular insurance group is relevant to overall financial stability, the establishment of a supervisory college is expected.
  - the relevance of a group to overall financial stability would be highly dependent on the nature, scale and complexity of the cross-border activities and/or intra-group transactions and associated risks of the group.
- The nature and complexity of the business undertaken by the group
  - where the cross-border activities of the group are highly complex - through intra-group transactions, etc. - the effectiveness of pure legal entity supervision can be limited without appropriate cooperation and information exchange with related supervisors. Therefore, the establishment of a supervisory college is expected.
- Relevance of the group in a specific insurance market

- where a particular group has significant market share in one or more specific jurisdictions, the establishment of a supervisory college may be expected.

- Similarity of supervisory practices (such as risk and capital assessment, governance assessment and other key supervisory practices) among the involved supervisors
  - where the group operates mainly in jurisdictions with similar supervisory frameworks and practices (e.g. the EEA), the establishment of a supervisory college would be more practicable, and therefore may be expected.
- The operational and management approach of the group:
  - where the group functions - risk management, capital management, corporate governance and internal controls - are centralised, the establishment of a supervisory college should be encouraged to facilitate dialogue between the involved supervisors and management of the group.
- Legal constraints limiting the effectiveness of supervisory college in the involved jurisdictions
  - Ensuring professional secrecy and confidentiality are vital elements in allowing supervisors to share and exchange relevant information. Where there are legal constraints to information exchange, the effectiveness of a supervisory college would be limited. In such a case, in considering the establishment of a supervisory college, supervisors should be encouraged to address any such legal constraints.

25.7.6 As a general point, where a supervisory college already exists in practice, but may not be comprehensive in its coverage (e.g. a regional college), that college may be adapted to meet the needs of the wider number of involved supervisors to the extent practicable. Involved supervisors should seek to avoid establishing duplicate supervisory colleges.

Form and operational structure of a supervisory college

25.7.7 The criteria discussed here are important considerations not only in determining whether and when to establish a supervisory college, but also where a college is established, in informing the definition of the form and operational structure of that college, its membership and the focus of its work.

Overall approach

25.7.8 The legal and regulatory frameworks that exist in jurisdictions where the group operates may vary considerably. This will place limitations on how each supervisor carries out its supervision of legal entities and the scope of its authority. This in turn will have an impact on any work that a supervisory college agrees to carry out. In particular, a supervisory college will need to ensure that any work planned does not go beyond the

authority of a supervisor or exceed the legal framework that exists in a jurisdiction.

25.7.9 The resources and capabilities of each supervisor involved in a supervisory college may vary considerably. As such the supervisory college will need to ensure that the activities agreed to are appropriate and realistic for all of the involved supervisors. This may require that:

- any tasks allocated are achievable for the supervisor carrying out the work; and
- the supervisory college focuses on the areas of greatest risk.

25.7.10 Supervisory approaches may differ by jurisdiction, for example some have adopted a principles-based approach to supervision while others use a rules-based approach. These differences will need to be considered and appropriately reflected in the form and operations of a supervisory college.

25.7.11 As already stated, supervisory colleges would generally be expected to be established on a permanent basis. However, there may be circumstances where a supervisory college is established on an ad-hoc basis in order to coordinate a particular issue with regard to the group in question (e.g. crisis management).

Membership of, and participation in, a supervisory college

25.7.12 The membership of a supervisory college would be expected to comprise representatives of each of the supervisors responsible for the day-to-day supervision of the insurers which are part of the group. While participation in a supervisory college is generally voluntary, broad involvement by the supervisors of the more significant entities is critical to the effective operation of that college. The terms, membership and participation should be interpreted in the context of these sections and in terms of every day usage. It is recognised that within the regulatory regimes of certain jurisdictions the terms may be defined for particular purposes and so take different meanings.

25.7.13 To facilitate effectiveness and efficiency, careful consideration should be given as to how to approach the participation of members at meetings and in other activities of the supervisory college. There is a need to balance the desire for an inclusive membership approach with the need to maintain manageable operational structures and to avoid the supervisory college becoming unwieldy and unworkable.

25.7.14 The basis of participation should be agreed among involved supervisors having due regard for the particular circumstances of the group. However, pragmatic solutions should be found to facilitate the operational functioning of the supervisory college in an effective and efficient manner.

25.7.15 In the case of a large group with entities operating in many jurisdictions, the number of involved supervisors may make it impracticable to involve all members in supervisory college meetings. A structured approach to participation could be considered where for example, participation in the supervisory college meeting is on the basis of regional representatives, where that representative is responsible for communication to and from

other regional supervisors. Another option may be to adopt a multiple tier structure of supervisory colleges, with subgroups of members identified and meetings organised to facilitate discussions at the subgroup levels (refer to below section on supervisory colleges at subgroup level).

25.7.16 Where participation in supervisory college meetings is limited, it is vital that other mechanisms, such as a secure members-only website be adopted to ensure the flow of information to and from all involved supervisors.

25.7.17 Further, clear criteria should be established for defining the basis of participation. Issues which should be considered in establishing these criteria include:

- the relative size and/or materiality of the entities relative to the group as a whole
- the relative size or materiality of the entity relative to its local market
- the level of risk in a particular entity
- the role of the supervisory college and its relevance to the particular entity.

25.7.18 Regardless of the approach to participation in a supervisory college, each involved supervisor is expected to make every reasonable effort to cooperate and coordinate in a spirit of mutual trust to ensure the protection of confidential information shared and to avoid unwarranted supervisory duplication and unnecessary supervisory burden for both the insurers and supervisors involved.

25.7.19 The membership and participation approach of a supervisory college should be reviewed on a regular basis, to reflect changing circumstances in the group and the effectiveness of the operational structures.

Supervisory colleges at subgroup level

25.7.20 Within a group, it is recognised that subgroups may be, or are required to be, identified to reflect various structural, operational or supervisory objectives. Such subgroups may exist within a jurisdiction or on a cross-border basis.

25.7.21 There may be circumstances where it is appropriate to establish a supervisory college at the level of such a subgroup (for example on a regional basis or sectoral basis, as in the case of an insurance group within a financial conglomerate). In the case of large groups, with many involved supervisors, such an approach may bring benefits in facilitating the involvement of all supervisors at an appropriate level.

25.7.22 When it is considered necessary to establish colleges at a subgroup level, supervisors should carefully consider the appropriate form and operational structure of the subgroup college, having regard to the circumstances of the group and supervisory structure, to facilitate its effective operation. In particular, supervisors may consider the following practical aspects of implementation:

- whether the subgroup college is established on a temporary or a permanent basis
- the interrelationships between the various supervisory colleges for a group, as well as the interrelationship with a designated group-wide supervisor
- mechanisms to facilitate effective and efficient information sharing and coordination between the various colleges
- ensuring the best dialogue with the industry without unnecessarily duplicating regulatory intervention (e.g. a dialogue at subgroup level).

25.7.23 Further, in these considerations supervisors should be aware of establishing mechanisms or processes to avoid the potential inefficiencies that may arise in a structure of subgroup colleges, such as:

- not providing material information at the subgroup level
- insufficient coordinated action/interventions at the subgroup level
- potential conflicts of interest between the subgroup and whole group
- duplication of supervision, by adding another layer.

25.7.24 Where supervisory colleges at subgroup level are implemented, regular assessment of their effectiveness and, in particular, the effectiveness of coordination between the various supervisory colleges for the group should be conducted.

Terms of reference of a supervisory college

25.7.25 When a supervisory college is first established, the involved supervisors may seek to underpin its establishment with a formal document - terms of reference - which sets out the agreed terms of operation of the supervisory college. While recognising the need to allow for flexibility in the operation of a supervisory college, the terms of reference could generally cover the following matters (this is not an exhaustive list):

- The membership of the supervisory college – including the approach to participation of members in the college.
- The process for appointing a supervisor for chairing the college. (This would typically but not necessarily be the group-wide supervisor, where designated.)
- Roles and functions of the supervisory college and of the members of the supervisory college, including expectations of the chair/designated group-wide supervisor.
- Frequency and locations of meetings – The supervisory college should agree locations that are likely to ensure the participation of as many of the members as possible. Where it is not feasible for supervisors to be present at a meeting, best endeavours should be made with the arrangements, so that where possible,

people can participate by other means – for example, by a conference call or electronic means.

- Scope of the activities of the supervisory college – It is likely that the supervisory college will focus on the following issues at a group level:
  - the solvency and financial stability of the insurance group;
  - the assessment of intra-group transactions and exposures;
  - internal control and risk management within the insurance group; and
  - appropriate actions to mitigate risks identified.

To be most effective in considering these issues, the supervisory college may develop a shared view of risk, including:

- the regular information collected by the supervisory college and any notifications that should be made to it (from both supervisors and the group). The supervisory college should agree the frequency at which information is provided. This should be coordinated in a way so as to avoid duplicative requests and to reduce the burden on a group. The supervisory college should have an overview of an insurance group's strategic plans;
- procedures for dealing with emergencies (including breaches of solvency positions or the crystallising of risk); and
- procedures for facilitating crisis management.

25.8 The designated group-wide supervisor establishes the key tasks of the supervisory college and other coordination mechanisms. Other involved supervisors undertake the functions of the Supervisory college as agreed.

25.8.1 A supervisory college is generally established for the fundamental purpose of facilitating the effectiveness of supervision of entities which belong to a group; both facilitating supervision of the group as a whole on a group-wide basis and improving the supervision of the legal entities within the group. A supervisory college serves this purpose by providing a permanent forum for cooperation and communication between the involved supervisors. Through the sharing of information and discussion of supervisory issues, involved supervisors gain an improved mutual understanding of supervisory practices, which may contribute to enhanced convergence of supervisory practice on a global basis.

25.8.2 The form, membership and operations of a particular supervisory college can be expected to vary according to the circumstances of the group and of the jurisdictions in which it operates. Appropriate flexibility in the establishment of a supervisory college, and the determination of its functions and operational structure, to reflect its particular circumstances is therefore important. A supervisory college should be organised in accordance with the nature, scale and complexity of the group; its form should be commensurate with the legal and organisational structure, business activities of the group and the risks the group poses to supervisory objectives.

25.8.3 Although a supervisory college has no legal or binding authority as a decision making body, in establishing the role and functions of a supervisory college, consideration should be given to the facilitation of coordinated supervisory activities. To the extent agreed among involved supervisors, and to the extent possible given any legal constraints in particular jurisdictions, this could include the delegation of tasks (but not legal responsibilities) and, where necessary, consistent and coordinated supervisory interventions. Ultimately any supervisory activity (including delegation of tasks) and coordinated supervisory interventions undertaken by a supervisory college will rely on cooperation among involved supervisors and does not override the various individual jurisdictions' legal responsibilities or existing supervisory relationships.

To facilitate group supervision

25.8.4 A supervisory college contributes to the coordinated supervision of the group and facilitates discussion and action on a collaborative approach to supervising a group, subject to any restrictions or requirements under each jurisdiction's legal framework.

25.8.5 A supervisory college supports the role of a group-wide supervisor, where designated, and assists the group-wide supervisor in undertaking its functions. A supervisory college facilitates information collection and analysis at the group level, including compiling and analysing information available on risk exposures, financial soundness and governance of group entities. With access to such aggregated information, a supervisory college may also enhance supervisory assessment of systemic risks.

To improve legal entity supervision

25.8.6 Through information collection and sharing, analysis and discussion, a supervisory college facilitates the transfer of knowledge and expertise among involved supervisors, and hence can contribute to improved supervision of the individual entities within the group. For example, effective cooperation may provide additional knowledge of the intra-group risks affecting an entity as a result of being a member of the group and may precipitate pre-emptive supervisory activities at the legal entity level.

As a permanent forum for cooperation

25.8.7 Where a supervisory college is established, to be most effective it should generally be established as a permanent, integral part of the group-wide supervision process. A supervisory college would generally be an ongoing mechanism, contributing to the ongoing protection of policyholders' interests. As such, an effectively operating supervisory college should contribute to the prevention of financial loss or crisis (as well as being an important mechanism to foster better crisis management in the circumstances of financial crisis).

25.8.8 A supervisory college provides a formal and effective permanent forum for supervisors to build relationships and engender greater cohesiveness in cooperating with each other and coordinating supervisory activities in

relation to the group and the entities within the group both on a going-concern basis and in situations of crisis management.

To facilitate improved understanding of supervisory practices and effectiveness of supervision

25.8.9 There may be significant variances in supervisory practices across jurisdictions, caused by the diversity of market environments and the specific features of a market which are better understood by the local supervisor. As supervisors work together through a supervisory college, they gain a greater understanding of the nature of the group and its risks. A supervisory college facilitates the transfer of knowledge and expertise to other supervisors allowing involved supervisors to become aware of different supervisory tools and approaches.

25.8.10 An important consequence of improving the understanding of supervisory practices among involved supervisors is the potential for enhanced supervisory convergence on a global basis. Also more effective and efficient group-wide supervision should result, with enhanced policyholder protection and a possible consequence of minimising regulatory burden on the industry.

The range of functions of a supervisory college

25.8.11 There is a range of functions which a supervisory college may undertake, depending on its role and the reasons for its establishment. The circumstances of the particular group and the legal and supervisory structures in the involved jurisdictions can also influence the range of functions of a supervisory college.

25.8.12 Ultimately, the involved supervisors should establish among themselves the appropriate functions of the supervisory college given its role, and the allocation of those functions among the involved supervisors. Where there is a designated group-wide supervisor for the group, that group-wide supervisor would be expected to play an integral and transparent role in the establishment and ongoing operation of the supervisory college, including taking the initiative in establishing and coordinating the functions of the supervisory college, in consensus with other involved supervisors.

25.8.13 The roles and functions of the supervisory college and the respective roles of the involved supervisors should be agreed and clearly defined to avoid unnecessary duplication of supervisory tasks and to ensure no gaps exist in the supervision of the group. For example, at its establishment the functions of a supervisory college may be set out in its terms of reference and the ongoing operations and activities of the supervisory college detailed in a supervisory plan. Where agreed among involved supervisors, delegation of supervisory tasks can be an appropriate means to increase efficiency of the work of a supervisory college.

25.8.14 In establishing the functions of a supervisory college, some of the key activities which should be considered include:

- information sharing;

- assessment of risk exposures, financial soundness and capital adequacy and group governance, including risk management, internal control and intra-group relationships;
- coordinated supervisory activities (for example, joint inspections);
- specialisation, special focus teams;
- liaison with insurer management; and
- regular assessment of effectiveness.

25.8.15 The key functions of supervisory colleges and other coordination mechanisms include an assessment, on a group-wide basis, of major risk exposures (including large external exposures). This includes, for example, supervisory review of the group's own risk and solvency assessment, transparency of the group structure and suitability of Senior Management and the Board. The supervisory review may also cover capital adequacy including approval of the use of a group-wide internal model for group-wide regulatory capital purposes (where applicable), large intra-group transactions and exposures, governance including risk management and internal controls, group crisis management arrangements and review of the effectiveness of these functions.

Information sharing

25.8.16 A main function of a supervisory college will be to facilitate enhanced supervision of the group and the legal entities within the group by providing greater access for involved supervisors to information and knowledge about the group and the environment in which it operates. Adequate information sharing arrangements are intended to provide supervisors with a vehicle to achieving a comprehensive understanding of the group and its risks while also protecting confidential information so that the group can be appropriately supervised.

25.8.17 The effective operation of a supervisory college is based on mutual trust and confidence among the involved supervisors. This is particularly the case in terms of sharing and exchanging information. As information is shared and exchanged in a secure and controlled environment, it both requires and encourages mutual trust. The supervisory college facilitates this relationship ultimately leading to greater cooperation.

25.8.18 The ability of each supervisor to share information should be determined to ensure that information remains confidential. The need to establish information sharing agreements should be considered to ensure confidentiality and define the parameters in which the information can be used. Supervisors are encouraged to initiate dialogue among themselves in order to identify ways in which they can foster an environment of cooperation and trust. Establishment of MoUs among involved supervisors could enhance the effectiveness of the supervisory college. Jurisdictions that are part of the IAIS MMoU will have had their legislative regimes assessed to ensure strict confidentiality requirements are met as a precondition for effective cooperation and coordination of joint supervisory activity.

Assessment of risks exposures, financial soundness and group governance

25.8.19 The range of functions of a group-wide supervisor could include consideration of the following issues on a group-wide basis: risk analysis and capital adequacy assessment (including review of the group's own risk and solvency assessment and the sufficiency and adequacy of allocation of capital across the group), fit and proper requirements and corporate governance and internal controls. As a mechanism for cooperation and coordination among involved supervisors and a forum for information exchange, an effective supervisory college may allow involved supervisors to gain an enhanced understanding of the group, its inherent risks, financial position and its business activities.

25.8.20 It is important for the involved supervisors to have a group-wide understanding of how management decisions are taken and how ERM frameworks and internal models are established and operated to complement their legal entity supervision of the entities within the group. The supervisory college provides a forum for involved supervisors to focus on risk assessment and capital management from a group-wide perspective.

25.8.21 A group-wide review and assessment of risks to which the group and its entities are or might be exposed can ensure a prospective focus of supervision and foster early warning of major risks to the extent possible. It can facilitate consideration of the impact of a group on the insurance industry, on other sectors of an economy, and any systemic risks which a group may present.

Coordinated supervisory activities

25.8.22 Through a supervisory college, joint activities among involved supervisors may be organised and coordinated where appropriate and as agreed on a voluntary basis between the involved supervisors, subject to any legislative requirements/restrictions. An example of a joint supervisory activity may be joint inspections of one or more group entities, or joint inspection of a particular aspect of the group's functions such as internal audit, actuarial function or risk management processes. Through joint activities, all involved supervisors can benefit from the shared information and expertise, and use this to enhance the supervision of their local insurer. The undertaking of joint activities should not be taken to imply joint decision making or any delegation of an individual supervisor's responsibilities.

Specialisation, special focus teams

25.8.23 A supervisory college may facilitate the formation of special focus teams to evaluate areas of particular concern or importance to the supervisors, or to bring together the requisite expertise to examine a specialised aspect of the group's operations. As an example, a specialised focus team may be established through the supervisory college to assess a group's internal model and to share that information with all involved supervisors.

Liaison with insurer management

25.8.24 The supervisory college provides involved supervisors an opportunity for discussion of issues with management at the group level. The supervisory college provides a forum for the supervisors and the insurer to engage in face-to-face dialogue. The insurer is afforded the opportunity to provide clarity with respect to its operations and its business strategies at a group-wide level. For the supervisors, the opportunity to discuss issues with management at the group level, and with a group-wide focus is valuable.

Regular assessment of effectiveness

25.8.25 Where a supervisory college is established, regular assessment of the effectiveness of the supervisory college in achieving its agreed role and functions should be conducted. Where a group-wide supervisor is designated, it would be expected that the group-wide supervisor would organise the assessment, ensuring input from all involved supervisors as well as considering the benefit of seeking input from the supervised insurers, to the extent appropriate.

Crisis management

25.8.26 Supervisory colleges can be an effective tool in reducing the likelihood of crises and averting them. In fact, they are a tool for crisis prevention that contributes to the safeguarding of overall financial stability. While, there may be circumstances where a supervisory college is established purely or exclusively as a vehicle for crisis management this would be expected to be the exception. Nevertheless, a high level of cooperation between supervisors is necessary for good crisis management which could be facilitated by the establishment of a supervisory college.

25.8.27 Since a supervisory college is a forum to engender cooperation and mutual trust among supervisors, an effectively operating supervisory college would result in established relationships which would be beneficial particularly in times of financial distress or a crisis. Regular cooperation and communication can, in fact, facilitate efficient action in times of crisis. Where a crisis situation arises, an existing supervisory college could function, and should be well positioned, to contribute to the management of that situation and to finding coordinated and agreed solutions.

25.8.28 It is important to be flexible in the use of a supervisory college with regards to crisis management. In fact the approach chosen needs to be able to adapt to the particular and individual situation. Other mechanisms of coordination might also be considered or needed.

25.8.29 To be effective in crisis management, it is essential for a supervisory college to provide mechanisms to exchange and communicate important information effectively and efficiently. The timely exchange of information is crucial, while always preserving confidentiality requirements. This may mean that, under very exceptional circumstances, highly sensitive information is only exchanged on a “need to know” basis. In addition, requirements to consult widely on supervisory actions which may be

appropriate in normal times may need to be limited in crisis situations to ensure necessary timely responses.

25.8.30 A supervisory college can also be used for the sharing of experiences and lessons learnt about crisis management i.e. more from the retrospective view. This way it can provide members with examples of good practices of crisis management.

Infrastructure in case of emergency/crisis management

25.8.31 While it is not expected to be the ultimate focus of a supervisory college, a crisis management plan should be discussed. In establishing the role and functions of any supervisory college it is important to consider the scenario of a crisis and the expected role of the college in that situation.

25.8.32 A supervisory college should consider, in advance, the due process of cooperation and coordination during emergency situations in order to benefit from well established information and cooperation channels and procedures once the crisis occurs. The channels for communication with the head of the group as well as other parts of the group should be clearly established in case a crisis emerges. The group-wide supervisor, where designated, should establish close liaison channels with group management and the Board of Directors as well as the owners of the group.

25.8.33 The supervisory college should have procedures in place which help involved supervisors to provide and receive all necessary information in a timely manner to facilitate well informed decisions within their own jurisdictions. Furthermore, there should be mechanisms in place related to the sharing of information on a voluntary basis.

25.8.34 The supervisory college may assist in performing and sharing crisis assessments as well as contribute to the management of a crisis. Therefore, comprehensive and up-to-date contact lists as well as realistic simulation exercises should be developed to increase crisis-resilience.

25.8.35 The approach to a crisis situation should appropriately reflect the nature, scale and complexity of the group and the particular crisis situation. It may be the supervisory college, as a whole, which responds to a crisis or a crisis management team. Alternatively, the supervisory college may establish a subgroup whose focus would be on crisis management aspects and, therefore, may be better capable to assess systemic risks.

25.8.36 The supervisory college should remain aware of the important role it will play in supporting the group-wide supervisor, especially in times of financial stress or crisis. Also the benefit of such a holistic approach is to provide the supervisory college with solutions for the best overall result for all jurisdictions and not just some. Members of the supervisory college should proactively identify, where possible, any conflicts of interest that may occur between their own jurisdictions and the relevant objectives of the supervisory college, and agree upon processes within the college to minimise any adverse and biased effect that may arise.

25.8.37 A supervisory college could also be a means for involved supervisors to coordinate on the timing and content of information that could be disclosed to/communicated with third parties (such as local

supervisory/regulatory bodies, international organisations or the public where appropriate) and the insurance group, both on an ongoing basis and/or in a crisis situation and in particular, where systemic risks exist taking into account confidentiality requirements. The supervisory college should identify any potential areas where the interests of third parties, in a crisis situation, may be in conflict with the relevant objectives of the college. As an example, confidentiality rules which determine the ability of individual authorities to communicate firm specific information may be a conflict.

25.9 The designated group-wide supervisor understands the structure and operations of the group. Other involved supervisors understand the structure and operations of parts of the group at least to the extent of how operations in their jurisdictions could be affected and how operations in their jurisdictions may affect the group.

25.10 The designated group-wide supervisor takes the appropriate lead in carrying out the responsibilities for group-wide supervision. A group-wide supervisor takes into account the assessment made by the legal entity supervisors as far as relevant.

Overall responsibilities of a group-wide supervisor

25.10.1 The group-wide supervisor, where designated, should be responsible for coordinating the input of legal entity supervisors in undertaking the supervision of a group on a group-wide basis, as a supplement to the legal entity supervision. However, all involved supervisors should recognise that group-wide supervision, and the designation of a group-wide supervisor, should not lessen the importance of legal entity supervision or replace the role of legal entity supervision in respect of the insurance entities in its own jurisdiction.

25.10.2 The group-wide supervisor should be responsible for producing an overall assessment of the risk and solvency of the group on a group-wide basis, taking into account the input of legal entity supervisors.

25.10.3 Group-wide supervision relies on substantial exchange of information. The exchange of detailed relevant supervisory information/data between the group-wide supervisor and the legal entity supervisors involved may be facilitated by the establishment of formal agreements (MoU/ IAIS MMoU) which should, necessarily, comprise compliance with a strict confidentiality regime. In establishing such agreements, involved supervisors should acknowledge that each supervisor may only provide information under the agreement to the extent permitted or not otherwise prevented under their respective jurisdictional laws, regulations and requirements.

The range of functions of a group-wide supervisor

25.10.4 There is a wide variety of roles and functions which a group-wide supervisor could take in meeting its overall responsibilities to coordinate and streamline group-wide supervision, depending on the circumstances of the group and the legal and supervisory structures in the involved jurisdictions.

25.10.5 Ultimately, the involved supervisors should establish among themselves the role and responsibilities of the designated group-wide supervisor and of the other involved supervisors at group level. The respective roles and responsibilities should be clearly defined to avoid unnecessary duplication of supervisory tasks.

25.10.6 The designated group-wide supervisor is expected to take the initiative in coordinating the roles of, and facilitating communication between, the involved supervisors. The group-wide supervisor should establish a supervisory plan in agreement with the involved supervisors. In carrying out its agreed functions, the group-wide supervisor should ensure that it acts in consensus with other involved supervisors.

25.10.7 In establishing the responsibilities of a particular group-wide supervisor, the key functions of a group-wide supervisor which should be considered include:

- Suitability of persons issues;
- Corporate governance;
- Internal control;
- Group-wide risk analysis;
- Capital adequacy on a group-wide basis; and
- Information sharing and key contact point function.

Suitability of persons issues

25.10.8 The group-wide supervisor assesses the propriety of significant owners at the group level.

25.10.9 The group-wide supervisor assesses the fitness and suitability of persons with managing or key control functions on group level. In doing this, the group-wide supervisor relies as much as possible on the suitability assessment carried out by the legal entity supervisors involved.

Corporate governance

25.10.10 The group-wide supervisor assesses the overall standard and compliance of corporate governance of the group. In cases where the parent company is not itself a supervised entity (e.g. holding company), the group-wide supervisor should assess the compliance with corporate governance requirements at the head of the group.

Internal control

25.10.11 The group-wide supervisor monitors whether the group provides internal control mechanisms, including sound reporting and accounting procedures, to monitor and to manage the intra-group transactions and the risk concentration.

25.10.12 In assessing the group's risk and capital management, the group-wide supervisor reviews the group's own risks assessment as required by Standard 16.16.

25.10.13 The group-wide supervisor assesses whether an insurance group has robust:

- risk management systems;
- internal control systems; and
- reporting processes

which are implemented and functioning consistently on a group-wide basis.

This will also include an assessment of the controls a group has in place around its proper and sound business practices with respect to the complexity of financial products sold to retail customers.

25.10.14 The group-wide supervisor monitors whether the group provides internal control mechanisms including adequate mechanisms with regard to group-wide solvency:

- to identify and measure all material risks incurred on a group-wide basis; and
- to appropriately allocate sufficient capital to risks.

25.10.15 The group-wide supervisor monitors whether policies on risk management within the group are laid down by written procedures and reviewed at least on an annual basis.

Group-wide risk analysis

25.10.16 The group-wide supervisor monitors the risk assessment, risk reporting as well as risk management on a group-wide basis. For this purpose, the group-wide supervisor should carry out a risk analysis of the group and its operating environment. This supervisor should be attentive to any sign for risk concentration and contagion. If the group has a centralised risk management function, the group-wide supervisor should monitor its proper functioning and implementation.

Capital adequacy on a group-wide basis

25.10.17 The group-wide supervisor takes the responsibility to assess and react to, as necessary, the prudential situation and solvency on a group-wide basis.

25.10.18 The group-wide supervisor assesses the sufficiency and adequacy of allocation of capital on a group-wide basis in order to gain a balanced view of the risk-based and financial situation of the group as a whole. Further elaboration on this can be found under ICP 17 Capital Adequacy.

Information sharing and key contact point function

25.10.19 To operate most effectively, the group-wide supervisor should receive from involved supervisors, on a timely basis, all information needed in order to form a comprehensive view of the overall group business strategy, financial situation, legal and regulatory position, and the risk exposure on a group-wide basis, in the most efficient way.

25.10.20 All involved supervisors have a responsibility to keep the group-wide supervisor updated in relation to the significant changes in the group structure and main operations.

25.10.21 In particular the involved supervisors should be encouraged to provide the group-wide supervisor with relevant key information in relation to:

- the legal structure of the entities belonging to the insurance group;
- any granting and withdrawal of licence for a company forming part of the group;
- changes on the Board or Senior Management of any insurer forming part of the group;
- changes in organisation or senior management;
- changes in risk management and internal control system;
- significant developments in the financial position of the insurance group or entities belonging to the insurance group;
- location of significant business;
- significant investments in group entities;
- significant financial links;
- transfer of risks to/from non–regulated entities;
- events which may endanger the going concern of the insurance group or major entities belonging to the insurance group;
- potential high risk factors for contagion; and
- operational risk including misselling claims and frauds.

25.10.22 The group-wide supervisor may at any time request further information needed for the assessment on a group-wide basis.

25.10.23 An involved legal entity supervisor may require information in relation to the group which proves necessary for a timely legal entity assessment of the insurer, or part thereof, located in its jurisdiction. The group-wide supervisor should make information available to the involved legal entity supervisors:

- on a proactive basis;
- without delay; and
- in a full and detailed manner.

25.10.24 The group-wide supervisor has a key contact point function for all legal entity supervisors involved. The key contact point function is of importance both in situations of going concern and in emergency situations.

ICP 26 Cross-border Cooperation and Coordination on Crisis Management

The supervisor cooperates and coordinates with other relevant supervisors and authorities such that a cross-border crisis involving a specific insurer can be managed effectively.

Introductory Guidance

26.0.1 The main objectives of supervisory crisis management are to protect policyholders and to prevent serious domestic or international financial instability which could have an adverse impact on the real economy. Supervisory actions seek to ensure, as far as possible, that insurers behave prudently; to promote private sector solutions such as portfolio transfers and run-offs and to avoid the need for using public support to protect policyholders and to safeguard financial stability; and to minimise distortions to the efficient operation of the insurance sector as well as across jurisdictions.

26.0.2 Effective cross-border crisis management requires international cooperation between supervisors and other relevant authorities (e.g. Ministries of Finance, central banks, other financial sector supervisors, guarantee schemes, policyholder protection schemes) through appropriate mechanisms for information exchange. Furthermore, it ensures that preparations for and management of a cross-border crisis including policy measures, crisis response decisions and matters of external communication are coordinated, timely and consistent.

26.0.3 Supervisors employ existing cross-border frameworks of cooperation (such as supervisory colleges or subgroups of them, bilateral MoUs or the IAIS MMoU) to prepare for and manage a cross-border crisis of a specific insurer. Where such channels do not exist, supervisors set up an appropriate framework for cooperation in line with other ICPs. Supervisors consider the application of this ICP in accordance with the nature, scale and complexity of insurers.

Preparation for a cross-border crisis

26.1 The supervisor meets regularly with other relevant supervisors and authorities to share and evaluate information relating to specific cross-border insurers and to analyse and assess specific issues (including whether there are systemic implications) in non-crisis periods.

26.1.1 These meetings may be held as part of a supervisory college (refer to ICP 25 Supervisory Cooperation and Coordination) or separately if no supervisory college is held or in place.

26.1.2 Supervisors remain aware of potential contagion channels, conflicts of interest and possible barriers to coordinated action in a crisis situation at specific cross-border insurers (such as legally required transparency rules in case of publicly listed companies or particular legislative requirements across jurisdictions).

26.1.3 The group-wide supervisor of the insurer will facilitate this process with involvement from other relevant supervisors (refer to ICP 25 Supervisory Cooperation and Coordination) and other relevant authorities.

26.2 The supervisor develops and maintains plans and tools for dealing with insurers in crisis and seeks to remove practical barriers to efficient and internationally coordinated resolutions.

26.2.1 These will be designed flexibly in order to be able to adapt them to the specific issues of a cross-border crisis as well as individual insurers.

26.3 The group-wide supervisor coordinates crisis management preparations with involvement from other relevant supervisors and ensures that all supervisors in the relevant jurisdictions (at a minimum those where the insurer is of systemic importance) are kept informed of the crisis management preparations.

26.4 As far as legal frameworks and confidentiality regimes allow, the supervisor shares with other relevant supervisors, at a minimum, information on the following:

- **group structure (including legal, financial and operational intragroup dependencies),**
- **interlinkages between the insurer and the financial system in each jurisdiction where it operates,**
- **potential impediments to a coordinated solution.**

26.5 The supervisory regime requires that insurers be capable of supplying, in a timely fashion, the information required to manage a financial crisis.

26.6 The supervisory regime requires insurers to maintain contingency plans and procedures based on their specific risk for use in a going- and gone-concern situation.

Managing a cross-border crisis

26.7 The supervisor informs the group-wide supervisor as soon as it becomes aware of an evolving crisis. The group-wide supervisor coordinates such that this information and any other relevant information that it has become aware of on its own is shared among other relevant supervisors and other relevant authorities promptly.

26.8 Subject to legislative requirements and confidentiality regimes, the supervisor shares information with relevant supervisors and authorities and in a way that does not compromise the prospects of a successful resolution. The supervisor shares information with other relevant authorities or networks as well, whenever necessary, and subject to the same legislative and confidentiality requirements.

26.9 The group-wide supervisor analyses and assesses the crisis situation and its implications as soon as practicable and supervisors try to reach a common understanding of the situation.

26.9.1 This includes the identification of possible sources of systemic risk and jurisdictional assessment of such implications.

26.9.2 The group-wide supervisor is responsible for coordinating the gathering and the analysis of information as well as for coordinating supervisory activities.

26.10 The supervisor cooperates to find internationally coordinated, timely and effective solutions.

26.10.1 Such cooperation takes account of the impact of the crisis on policyholders, financial systems and real economies of all relevant jurisdictions, drawing on information, arrangements and crisis management plans developed beforehand.

26.11 If a fully coordinated supervisory solution is not possible, the supervisor discusses jurisdictional measures with other relevant supervisors as soon as possible.

26.11.1 The supervisor takes into account that other authorities (e.g. Ministries of Finance) may take part in and be responsible for crisis management, especially if the crisis is of a very severe nature and may require the use of public funds.

26.12 In a crisis situation, the group-wide supervisor coordinates public communication at each stage of the crisis.

26.12.1 The supervisor, where practicable, shares its plan for public communication with other relevant supervisors from other affected jurisdictions to ensure that communication is handled in a coordinated and timely way.

26.12.2 Where appropriate, the supervisor considers when and to what extent to communicate with the insurers.