

OFFSHORE GROUP OF INSURANCE SUPERVISORS



INSURANCE SUPERVISORY PRINCIPLES

INSURANCE CORE PRINCIPLES METHODOLOGY

SEPTEMBER 2000

GUIDELINES TO COMPLIANCE

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August 2000

Introduction.

In June 2000 OGIS resolved to adopt the International Association of Insurance Supervisor's Insurance Supervisory Principles and Insurance Core Principles Methodology for its own use. Compliance by members is to become mandatory; however, in determining such compliance, the distinctive nature of the insurance business of the jurisdictions within the OGIS membership is to be taken into account

These Guidelines are intended to provide the individual OGIS insurance supervisors with an easy to follow yardstick with which they might measure their degree of compliance with what has become, albeit with some justification, a complex set of documentation. The original sets of criteria for each of the Insurance Core Principles are listed therein under two sets of headings, "essential criteria" and "additional criteria". The first are those elements which should be implemented in order to demonstrate full observance of the Principles; the second are those elements which further strengthen supervision and are recommended for improved financial stability and effective supervision, and which "may be particularly relevant to the supervision of more sophisticated insurance companies or may be needed in instances where international business is significant or where local markets tend to be highly volatile". Hopefully, broad compliance along the lines set out in these guidelines will also ensure compliance with the minutiae of the criteria, essential and otherwise, as set out within the full documentation.

For ease of reference the basic Principles, as found in the IAIS Insurance Core Principles Methodology (draft of 24/06/00) will be repeated, section by section, within this document, the reader is invited to immerse himself in the detail of the Methodology and underlying Standards, and related Guidance papers, textbooks and Issues papers at his leisure.

Underpinning all the following should be the solid base of legislation, insurance, of course, but also legislation indispensable to the insurance sector such as commercial code, civil code, company law, tax law and banking law. A comprehensive set of high quality prudential regulations and standards is vital if insurance supervisory authorities are to exercise their powers and responsibilities in a coherent fashion.

Principle 1- Organisation of an Insurance Supervisor.

The insurance supervisor of a jurisdiction must be organised so that it is able to accomplish its primary task, i.e. to maintain efficient, fair, safe and stable insurance markets for the benefit and protection of policyholders. It should be able at any time to carry out this task efficiently in accordance with the Insurance Core Principles. In particular the insurance supervisor should:

Guidelines.

The key elements here are **independence, resources and professionalism**. Independence is important because the supervisor should be free of any political or industry pressures in exercising his responsibilities; likewise the composition of the body (Commission, Board, etc.) to which he is responsible should be balanced, without an industry majority. However the body may be funded (industry levy or other means) its independence should be preserved. Resources (legal backing, staff, accommodation, technical support, budget) should all be **adequate to function to a high** level of efficiency, including the practice of “fit and proper” checks on existing and prospective market participants. Professionalism, including confidentiality, should go without saying, the supervisory office should be able to relate to the industry on an equal level, understanding its business, its aspirations and strengths and weaknesses. Confidentiality should be respected, but not to the extent of preventing networking around the regulatory community. Confidentiality on the part of staff should be secured by way of signed undertaking.

The whole of the operation of the supervisory body should be transparent, possibly accomplished by way of guidelines published for the industry.

Whilst it is recognised that within OGIS there is a wide diversity of size and mix of markets, with resultant variations in size and composition of regulatory offices, it is important that each office is able to meet the above expectations. Numbers of staff are by no means a guide to efficiency and professionalism. Small, but highly trained, teams with very experienced leaders are likely to predominate, which have taken advantage of such training programmes/courses as are available from time to time. Such teams will normally, in addition to the leader, include a qualified insurance accountant, a statistician, and at least one person under training. Whatever the size of the team it must be adequate to cope with the demands arising from the proper exercise of its responsibilities.

Principle 2 - Licensing.

Companies wishing to underwrite business in the domestic insurance market should be licensed. Where the insurance supervisor has the authority to grant a licence, the supervisor:

Guidelines.

Within the Methodology this Principle is broken down into three parts, these notes will follow likewise.

Principle 2(1) Companies wishing to underwrite business in the domestic insurance market should be licensed.

To take captive insurance business into account this Principle should be broadened to encompass all persons engaged in the business of insurance both within and from within the jurisdiction, although comments on market participants other than insurers will be dealt with under the Market Conduct section.

From this point forward all comments are predicated on the assumption that an insurance law is in place which provides both for the establishment of the supervisory office and the on going supervision of the insurance industry. Such law will contain, inter-alia, definitions of insurance business and the types of entities which must be licensed, the licensing requirements, financial reporting requirements, powers of the supervisor, confidentiality provisions, penalties for non compliance and the requisite regulations.

The Law should then provide a complete foundation for the efficient functioning of the supervisory office. In practical terms, however, guidelines should be issued covering the application process, the annual reporting requirements and any other aspects which may be identified in the particular jurisdiction. These guidelines will set out the supervisor's expectations with regard to documentation to be provided, especially the business plan within the application, and notes on the acceptability of assets/investments and reinsurance. They should also give an indication of the likely time frame for processing applications and annual reports.

Principle 2(2) The supervisor, in granting a licence, should assess the suitability of owners, directors, and/or senior management, and the soundness of the business plan, which could include pro forma financial statements, a capital plan and projected solvency margins.

The application document itself should be as comprehensive as possible, designed to reveal every aspect of the proposed venture, its ownership, source of funds, business plans (which, without doubt, should include full financial projections for at least three years ahead - see Annex One and Two) and corporate governance principles. Supporting services such as accounting, banking, auditing, investment management and, in captive business, local management, should also be identified. It is helpful to also have draft Memorandum and Articles (By-laws) at application stage, and although not mentioned within the Principles, it is suggested that provisions for Bearer shares should not be accepted.

New indigenous local insurers should be subject to the same rigorous investigation as any others, and the proposal judged entirely on its own merits. The business plan should deal comprehensively with marketing strategy, rating structure and claims settlement procedures.

For all domestic business there should be a policy in force of separation of General and Life business, which should not be carried on within the same company. The policy may be relaxed for captive insurance business provided the supervisor is satisfied that the integrity of the life funds is secured, for instance by way of companies operating under Segregated Portfolio, Protected Cell or other similarly designated legal provisions.

External insurers wishing to enter the jurisdiction for the first time may be the subject of enquiry of their home supervisors, good standing and satisfactory marketing being key issues.

For proposed captive insurers/reinsurers it is particularly important to obtain full details of the business producers and all related parties in the chain, and a clear statement from the investors as to their aspirations of the venture. Meetings with the principles and the local manager are extremely useful in this regard. The supervisor should also have the capability to pursue enquiries with other supervisors/agencies which may hold information on the parties. No company, however limited its operation, should be exempt from this process.

In all cases the usual "fit and proper" checks should be made on all shareholders (say holding more than 10%), directors and senior managers. These should be designed to ensure that all parties have the utmost integrity, appropriate expertise, and are without criminal conviction and have not been involved in any fraudulent or suspicious activity, including money laundering.

Finally, the supervisor should have the ability to refuse a licence to any applicant who fails to satisfy any of the application criteria.

Principle 2(3) The supervisor, in permitting access to the domestic market, may choose to rely on the work carried out by an insurance supervisor in another jurisdiction if the prudential rules of the two jurisdictions are broadly equivalent.

In dealing with an application by an insurer already domiciled and licensed elsewhere the supervisor may choose, provided the supervisory regimes are similar, to depend upon information exchanged with the home supervisor (on a confidential basis).

It is important to not read this **Licensing** section in isolation, all the following sections impact licensing to some degree or another with **Sanctions** being particularly important.

Principle 3 - Changes in control (not applicable to mutual companies).

The insurance supervisor should review changes in control of companies that are licensed in the jurisdiction. The supervisor should establish clear requirements to be met when a change in control occurs. These may be the same as, or similar to, the requirements which apply in granting a licence. In particular, the supervisor should:

Guidelines.

The insurance law should define what constitutes a change of ownership, and provide that when such a change is contemplated the likelihood of same be reported by both the acquiring and selling parties to the supervisor. This report should include an outline of any proposed changes in the structure of the company, its operation and its business plan.

A significant change of control should require the submission of a full application as for a new company so that all aspects of the proposal can be fully checked.

Drafting note: the Principles do not address what constitutes a change nor do they deal with partial changes, nor with at what stage a change should be reported. I believe the guideline represents best practice - "significant" could be construed as more than 50/0.

The supervisor should have the power to reject the change in control - this implies that the change should be notified in advance since it would be unbusinesslike to reject a change after it had been accomplished.

Principle 4 - Corporate Governance

It is desirable that standards be established in the jurisdictions which deal with corporate governance. Where the insurance supervisor has responsibility for setting requirements for corporate governance, the supervisor should set requirements with respect to:

- the roles and responsibilities of the board of directors;
- reliance on other supervisors for companies licensed in other jurisdictions, and
- the distinction between the standards to be met by companies incorporated in his jurisdiction and branch operations of companies incorporated in another jurisdiction.

Guidelines.

It is recognised that few, if any, of the insurance laws of OGIS members may address corporate governance but in the light of the attention currently being paid to this issue it is suggested that in those instances where the issue is not

covered by other authorities/regulators in the jurisdiction consideration might be given to making the requisite provisions within the insurance laws.

Meanwhile supervisors should take an active interest in corporate governance and should encourage insurers to adhere to corporate governance principles, and for their boards to set out their responsibilities towards acceptance of, and commitment to, the specific corporate governance principles for their undertaking.

Boards should be encouraged to set out strategic objectives, and the means of attaining and then monitoring and evaluating same. Responsibilities and accountabilities should be clearly defined as between the chairman, chief executive and all levels of management. Internal and external audit functions and remuneration policies should be addressed. Complaints procedures for customers should be clearly understood and communicated to all concerned.

Whilst the main thrust of the above is directed at domestic insurers it would seem to be reasonable to extend its scope to cover captive insurance managers and their client companies. Captive management companies may be expected to have their own corporate governance principles and their boards of directors the same responsibilities, corporately, as an insurer. In all cases the relationship between the manager and client, including the responsibilities of the client directors, should be drawn into the consideration.

It is suggested that a practical approach to becoming involved in this issue might be for the supervisor to write to all his licensees (other than captive insurers) asking for the submission of a description of the licensee's corporate governance principles and the way in which they are followed through. Once this information has been received and digested further action could be formulated; this could range from issuing guidelines as to the supervisors' expectations to simply periodically checking that satisfactory arrangements continue to operate. The latter should be a permanent component of on-site inspections. New applicants should be asked to address this issue within their application documentation.

Principle 5 - Internal Controls.

The supervisor should be able to:

- review the internal controls that the board of directors and management approve and apply, and to require strengthening where necessary; and
- require the board of directors to provide suitable prudential oversight, such as setting standards for underwriting risks and setting qualitative and quantitative standards for investment and liquidity management.

Guidelines.

The supervisor should require boards to have in place internal controls that are adequate for the nature and scale of their business, including organisational structure, accounting procedures, checks and balances, safeguarding assets and customer related issues. Boards and senior management should demonstrate that they understand the underlying risks of their business, and that there is an appropriate balance of skills for handling both back and front office functions.

In addition boards should be required to have in place an appropriate, adequately resourced, independent audit function with unfettered access to all departments and a formal procedure to deal with suspicious &/or money laundering transactions including appropriate reporting procedures.

As for corporate governance, these considerations will apply to both insurers and captive insurance managers.

The supervisor may obtain satisfaction on the above counts by way of a reporting procedure backed up by periodic on-site inspections. New companies should be asked to file a commentary on their proposed internal controls as part of the application process which could be regularly updated as part of their annual return. A check list of the many areas to be covered based on the essential criteria attached to this section of the Principles is found at Annex Three.

Principle 6 - Assets.

Standards should be established with respect to the assets of companies licensed to operate within the jurisdiction. Where insurance supervisors have the authority to establish the standards, these should apply at least to an amount of assets equal to the total of the technical provisions, and should address:

- diversification by type;
- any limits or restrictions on the amount which may be held in financial instruments, property, and

Guidelines.

At the outset it is important to remember that investment policies are the responsibility of boards of directors and not the supervisor. The Supervisory Standard on Asset Management says:

*“The **board of directors** should be responsible for the formulation and approval of the strategic investment policy, taking account of the analysis of the asset” liability relationship, the insurer ‘s overall risk tolerance, its long term risk return requirements, its liquidity requirements and its solvency position. “ **And** supervisors in monitoring the asset management of insurance companies, “must satisfy themselves that companies have the ability to identify, monitor, measure, report and control the associated risks”.*

It is anticipated that the supervisor will therefor take a close interest in assets, their suitability and their management. Given the diverse nature of insurance business within the OGIS membership, and the complexity of the Methodology, it is suggested that a step by step approach be taken.

First, the supervisor should become broadly familiar with the investment policies of both domestic and captive insurers within the jurisdiction. If this is a first time exercise and the requisite information has not already been filed (for instance with the business plan) the objective could be accomplished through company visits, or, as with corporate governance, by way of the written submission of the insurer’s policy.

Second, the extent to which investments, and powers of the supervisor, are dealt with in the respective insurance laws and regulations should be reviewed.

Third, a review of the basic elements of the Methodology should be undertaken and consideration be given as to what actions might be necessary to ensure compliance, taking the particular nature of the markets into account (which would include the common practices of captive insurance managers in contracting out services such as investment management).

The basic elements of the Methodology are seen as:

The supervisor should be able to **require** insurers to:

- have in place an overall strategic investment policy;
- have in place comprehensive risk management systems;
- allocate responsibility for the oversight of, and clear management accountability for, investment policies and procedures to the Board of Directors; and

to check that insurers:

- have in place adequate internal controls to ensure that investment policies are followed

- have in place rigorous audit procedures;
- monitor their asset/liability position relative to their liability profiles;
- ensure that the board of directors review the adequacy of their investment policy at least annually.

In addition the supervisor should have the power determine the suitability of assets and mix on a case by case basis.

Principle 7 - Liabilities .

Insurance supervisors should establish standards with respect to the liabilities of companies licensed to operate in their jurisdiction. In developing the standards, the supervisor should consider:

- what is to be included as a liability of the company, for example, claims incurred but not paid, claims incurred but not reported, amounts owed to others, amounts owed that are in dispute, premiums received in advance, as well as the provision for policy liabilities or technical provisions that may be set by an actuary;
- the standards for establishing policy liabilities or technical provisions; and
- the amount of credit allowed to reduce liabilities for amounts recoverable under reinsurance arrangements with a given reinsurer, making provision for the ultimate collectability.

Guidelines.

The supervisor should have the power to set standards for the establishment of technical reserves and other liabilities, to check the sufficiency of same, and to require changes if considered necessary. Likewise the supervisor should be able to intervene in reinsurance arrangements, including setting limits on allowable recoveries.

Of course, checking the sufficiency of reserves is a very tall order! A thorough check would require the company to describe its reserving policy in detail, identifying the historical statistical data used (loss development patterns etc.) an analysis of past year's reserving accuracy class by class, inflationary trends, collectable and uncollectable reinsurance, and so on. It also implies that the supervisor has the technical resources to allocate to such work.

The financial statement of the insurer should disclose the amount of credit allowed to reduce liabilities for amounts recoverable under reinsurance arrangements.

Technical provisions of life insurers should be always be subject to actuarial assessment, and the supervisor should have the authority to require similarly for a general insurer if thought appropriate.

Principle 8 - Capital Adequacy and Solvency.

The requirements regarding the capital to be maintained by companies which are licensed or seek a licence in the jurisdiction, should be clearly defined and should address the minimum levels of capital or the levels of deposits that should be maintained. Capital adequacy requirements should reflect the size, complexity, and business risks of the company in the jurisdiction

Guidelines.

The important issue here is that the supervisor should have the power to set adequate capital and solvency limits, and to see that they are maintained. Most insurance laws stipulate minimum capital levels which are often, for all practical purposes, far below those which the supervisor may consider prudent. Generally insurers will set their own levels, which will reflect the nature of their particular business and the consequent exposures; but insurers and supervisor may not always agree as to adequacy so the supervisor should be able to require an insurer to hold capital at a higher level than the statutory minimum, and also to require an actuarial or other professional opinion on the company's solvency position.

Since level of capital is one thing, and composition of same quite another, the supervisor should also have the power to determine the acceptability of the elements of the capital.

Guidelines may be issued in this area, for instance that the capital should be free of all foreseeable liabilities, or that certain investments will not be acceptable. It is recognised that there are already established solvency practices in various countries/regions which could be of assistance when regulating the domestic industry, but more often than not, especially in the captive market, the levels will need to be determined by mutual agreement.

Finally the supervisor should require an annual report on the insurer's capital and solvency position to be filed as part of the annual return, and the insurer should be required to report at any time should the solvency position be under threat. In the latter case the supervisor should have the power to set conditions for remedial actions which could range from injection of further capital to restrictions on new business to withdrawal of licence.

Principle 9 - Derivatives and "off-balance sheet" items.

This section applies in jurisdictions where derivatives or other items are not reported on the balance sheet and are thus not subject to the reporting requirements established for financial statements.

The insurance supervisor should be able to set requirements with respect to the use of financial instruments that may not form part of the financial report of a company licensed in the jurisdiction. In setting these requirements the supervisor should address:

- restrictions in the use of derivatives and other off-balance sheet items;
- disclosure requirements for derivatives and other off-balance sheet items; and
- the establishment of adequate internal controls and monitoring of derivative positions.

Guidelines.

This principle only applies where investment in derivatives can be made but are not subject to disclosure requirements so the supervisor may be unaware of such investments, so perhaps the easiest way to deal with it would be to ensure that disclosure requirements are in place. If that is not possible the following should be considered.

If the supervisor determines that such investments are, in principle, to be admitted some statutory authority for monitoring them, and any other off-balance sheet items should be introduced.

As with regular investments, it is not the role of the supervisor to advise a company on asset management policy, that being the responsibility of the company directors, but the supervisor will need to be able to satisfy himself that the company has adequate policies and procedures in place for the use of derivatives and to restrict their use if necessary.

As a guide to what an appropriate policy might be the Principles say:

“the policy must be consistent with the company’s activities, its overall strategic investment policy and asset/liability management strategy, and its risk tolerance.

In more detail the policy should address the purposes for which derivatives can be used, acceptable types and exposure limits, and the lines of responsibility and framework of accountability for derivatives functions.

As to procedures the supervisor should look for comprehensive systems which will track the risks arising from derivatives activities so that they can be monitored, analysed and assessed. The company should be able to satisfy itself that all transactions are entered into only in accordance with the investment policy by way of proper controls linked to an internal independent audit. In short, derivatives will be subject to the same checks as those for assets.

Principle 10 - Reinsurance

Insurance companies use reinsurance as a means of risk containment. The supervisor must be able to review reinsurance arrangements, to assess the degree of reliance placed on these arrangements and to determine the appropriateness of such reliance. Insurance companies would be expected to assess the financial positions of their reinsurers in determining an appropriate level of exposure to them.

The supervisor should set requirements with respect to reinsurance contracts or reinsurance companies addressing:

- the amount of credit taken for reinsurance ceded. The amount of credit taken should reflect an assessment of the ultimate collectability of the reinsurance recoverables and may take into account the supervisory control over the reinsurer, and;
- the amount of reliance placed on the supervisor of the reinsurance business of a company which is incorporated in another jurisdiction.

Guidelines.

This Principle has been subject to much debate and consequent reworking, due mostly to the divergent views within IAIS as to the way in which reinsurance companies should be regulated. It is suggested that within the OGIS community there should be **no difference** between the supervision of insurers and reinsurers.

It is recognised that within the OGIS jurisdictions most domestic insurers, and captive insurers and reinsurers, depend heavily on reinsurance to be able to function to any degree of success in their respective markets. Some of this reinsurance will be provided by companies within the same jurisdiction, some by companies within the broader OGIS family, and some, probably the majority, by companies domiciled elsewhere and usually operating in the international marketplace. The supervisor will, as part of the review process both at application and annual return stages, become familiar with the names and domiciles of an insurer’s reinsurers. Whilst it is accepted that the primary responsibility for the construction of a reinsurance programme and the selection of the reinsurers to be used rests with the insurer the supervisor will need to validate information provided, consequently he should also become familiar with the reinsurer’s rating (Best’s, S&P’s etc.) and good standing in its home jurisdiction, information essential in the assessment and approval of any reinsurance programme.

It follows that the supervisor should have the ability to exchange information on reinsurers confidentially with supervisors in other jurisdictions in which the reinsurer may be operating.

Further the supervisor should have the ability, for good reason, to refuse a particular reinsurer, and to disallow credit for reinsurance recoveries if there are doubts as to the ultimate collection of claims.

As to the licensing of reinsurers, this should be dealt with in exactly the same way as for insurers.

Principle 11 - Market Conduct.

Insurance supervisors should ensure that insurers and intermediaries exercise the necessary knowledge, skills and integrity in dealings with their customers.

Insurers and intermediaries should:

- at all times act honestly and in a straightforward manner;
- act with due skill, care and diligence in conducting their business activities;
- conduct their business and organise their affairs with prudence;
- pay due regard to the information needs of their customers and treat them fairly;
- seek from their customers information which might reasonably be expected before giving advice or concluding a contract;
- avoid conflicts of interest;
- deal with their regulators in an open and cooperative way;
- support a system of complaints handling where applicable; and
- organise and control their affairs effectively.

Guidelines.

This Principle is very comprehensive for dealing with the **domestic marketplace, and most of** the essential criteria listed within the Methodology are simply repeats of elements of the Principle. Not listed are:

- Supervisors must have the capability to carry out on-site inspections to check observance of the required standards of market conduct where necessary.
- Supervisors must set policy and guidelines with regard to disclosure to the customer of relevant, meaningful and understandable information in a timely manner.
- Supervisors must deal with persons or entities doing unauthorised business quickly and effectively.

As a guide to practical implementation of this Principle it could be said that the supervisor should know the local industry, enjoy a good working relationship with it, have high expectations of it, and have adequate powers to intervene quickly where necessary.

The industry in turn should be encouraged to operate openly and effectively, assisted through professional associations and training programmes, possibly, in terms of setting examinations for agents, in conjunction with the supervisory office.

The Principle does not, however, deal specifically with the **offshore marketplace**, and particularly those firms, usually called Captive Insurance Managers, or Underwriting Managers, which provide services to captive insurance companies. (It must be said that the reputation of any jurisdiction as a “captive” domicile depends as much upon the managerial expertise available as much as its regulatory environment.) Consequently the first element of the Principle should be extended to include

- Supervisors must ensure that captive insurance managers have and exercise the necessary knowledge, skills and integrity in dealings with their clients, and have adequate resources to fulfil their contractual obligations.

To meet this element the supervisor should take particular care at the initial licence application stage, and subsequently exercise a regular on-site inspection programme, which should include reviewing the work input of any sub-contractors, for instance investment managers.

Principle 12 - Financial Reporting.

It is important that insurance supervisors get the information they need to properly form an opinion on the financial strength of the operations of each insurance company in their jurisdiction. The information needed to carry out this review and analysis is obtained from the financial and statistical reports that are filed on a regular basis supported by information obtained through special information requests, on-site inspections and communication with actuaries and external auditors.

A process should be established for:

- setting the scope and frequency of reports requested and received from all companies licensed in the jurisdiction, including financial reports, actuarial reports and other information;
- setting the accounting requirements for the preparation of financial reports in the jurisdiction;
- ensuring that external audits of insurance companies operating in the jurisdiction are acceptable; and
- setting the standards for the establishment of technical provisions or policy and other liabilities to be included in the financial reports in the jurisdiction.

In so doing a distinction may be made:

- between the standards that apply to reports and calculations prepared for disclosure to policyholders and investors, and those prepared supervisor; and
- between the financial reports and calculations prepared for companies incorporated in the jurisdiction, and branch operations of companies incorporated in another jurisdiction.

Guidelines.

The supervisor cannot do his job at all adequately without a system which provides for the timely submission and review of financial returns from insurers. This implies that such returns should be on a statutory basis, and that the supervisor has the necessary qualified technical staff support both to conduct the reviews in a timely fashion and to draw conclusions from same, reporting their findings, again in a timely manner, with any unsatisfactory findings being reported instantly. Although not mentioned specifically within the IAIS document a further corollary is that the supervisor should have the ability to respond to such **reports as soon as any deficiency is identified**, ensuring that concerns are shared with the insurer, and appropriate remedial measures taken.

In more detail:

The returns will be required on a statutory (prescribed) basis, usually annually within a specified time frame, but for new companies possibly quarterly, and will include a copy of the published audited accounts. The supervisor should have the power to set the scope of the requisite basic detail and to call for further information on a case by case basis. The statutory return should include details of off-balance sheet items not necessarily disclosed in the published accounts.

Actuarial opinions will be the norm for life insurers, and may possibly be required for other classes of long tail liabilities, in respect of which loss development charts (triangulations) should also be provided. The latter being most useful in validating the adequacy of loss reserves and IBNRs.

Full details of outstanding reinsurance recoveries should always be provided, charted by age, and uncollectible amounts identified.

Information filed should be subject to periodic verification by way of on-site inspections, either by the supervisor or external auditors.

Principle 13 - On Site Inspections.

The insurance supervisor should be able to:

- carry out on-site inspections to review the business and affairs of the company, including the inspection of books, records, account and other documents. This may be limited to the operation of the company in the jurisdiction or, subject to the agreement of the respective supervisors, include other jurisdictions in which the company operates: and
- request and receive any information from companies licensed in his jurisdiction, whether this information be specific to a company or be requested of all companies.

Guidelines.

The supervisor should have the authority to conduct on site inspections of all licensed entities in its jurisdiction, covering all aspects of the licensees activity. Such authority to extend to compliance with any required remedial action.

Inspections may be delegated to external auditors or actuaries, subject to the supervisor being able to satisfy himself as to their competence, independence and his own ability to monitor their performance. Such external inspectors should be subject to the same confidentiality restrictions as the supervisor.

There is no recommended frequency of inspections, possibly every three years is reasonable, but the supervisor must be able to mount an inspection at any time it is felt appropriate.

The IAIS Supervisory Standard on On-Site Inspections says:

“generally speaking, the key objective of any on-site inspection is the appraisal of the company’s current and prospective solvency. More specifically, the objective is to compare the risk profile of the company with its risk carrying capacity and to detect any problem that may affect the company’s capacity to meet its obligations towards policyholders in the long term. “

A full scale on-site inspection of an insurer must include at least the following

evaluations of the management and internal control system, the technical conduct of insurance business and of the company’s financial strength; and

analyses of the company’s activity, its customer relationships and of the relationship with external entities.

Captive insurers which contract their management to local insurance managers will not be inspected per se but the managers themselves should be subject to similar regular inspections. In these particular attention should be paid to the client insurer’s corporate records (board minutes etc.) and accounting records (regular preparation of management accounts) and investment management.

Brokers too should be included within the inspection programme.

Principle - 14 Sanctions.

Insurance supervisors must have the power to take remedial action where problems involving licensed companies are identified. The supervisor must have a range of actions available in order to apply appropriate sanctions to problems encountered. The legislation should set out the powers available to the supervisor and may include:

- the power to restrict the business activities of a company, for example, by withholding approval for new activities or acquisitions;
- the power to direct a company to stop practices that are unsafe or unsound, or to take action to remedy an unsafe or unsound business practice, and
- the option to invoke other sanctions on a company or its business operation in the jurisdiction, for example, by revoking the licence of a company or imposing remedial measures where a company violates the insurance of the jurisdiction.

Guidelines.

In a nutshell, the supervisor should have the legal authority to take remedial actions against, and impose penalties upon, problem companies. Such actions to include the provision of recovery measures to be taken within a defined timescale.

The supervisor should be able to deal with a problem company by way of control of assets, suspension of claims/surrender payments, appointment of a temporary administrator, and if necessary to withdraw a licence and ensure an orderly run off, or transfer, of the portfolio.

The above criteria are reasonably straightforward to meet within the domestic marketplace, but dealing with a problematic captive insurer/reinsurer may be a much more difficult matter, particularly if the captive is operating as a direct insurer in the U. S. surplus lines market, or is offering reinsurance facilities through various brokers on a world-wide basis. In such instances the supervisor will need to enlist the support of the supervisory authority, surplus lines association or even law enforcement where the company is actually doing business. If fraud or money laundering is suspected the whole anti-fraud network may need to be involved, not forgetting the resources which OGIS, collectively, can bring to bear.

In the whole of this area timely action is of the essence, warnings may be issued, restrictions may be imposed and time scales established, all of which may be ineffective unless the problem company's response is carefully monitored and threatened action, where necessary, is actually carried through.

Principle 15 - Cross-border Business Operations.

Insurance companies are becoming increasingly international in scope, establishing branches and subsidiaries outside their home jurisdiction and sometimes conducting cross-border business on a services basis only. The insurance supervisor should ensure that:

- no foreign insurance establishment escapes supervision;
- all insurance establishments of international insurance groups and international insurers are subject to effective supervision;
- the creation of a cross-border insurance establishment is subject to consultation between host and home supervisors; and
- foreign insurers providing insurance cover on a cross-border services basis subject to effective supervision.

Guidelines.

This is a rather lengthy and complicated section, due mainly to the different company operating combinations to be taken into account. The insurance law of the jurisdiction should require that all insurance establishments of international insurers, insurance groups and conglomerates operating within the jurisdiction be subject to effective continuing supervision, irrespective of any licensing requirement. Then it is necessary to consider:

Insurance subsidiaries of foreign parent companies, and insurance ventures in which one or more of the parent institutions is incorporated in a different jurisdiction, these should be subject to the supervision of their capital adequacy / solvency in the jurisdiction of incorporation.

Foreign branches which are an integral part of an insurer incorporated in another jurisdiction should be subject to continuing direct supervision in the host jurisdiction unless the supervisor has sound basis to believe that both company and branches are effectively supervised by the home supervisor.

Where a licence application is made by any of the above entities the supervisor should consult the home supervisor.

Where the **cross border promotion of insurance contracts on a service basis by a foreign insurer is permitted** the supervisor should have appropriate procedures in place to protect policyholders. Where a notification or special licensing procedure is in place it should include checks that the foreign insurer is subject to continuing effective prudential supervision in its home jurisdiction over its global activities. If the supervisor has material concerns in this regard he should have the ability to impose additional conditions on the licence, or refuse it altogether.

The supervisor should have power to prevent insurers established within his jurisdiction from promoting contracts of insurance **through a branch or on a cross-border services basis** in foreign jurisdictions where the insurer does not have the required financial capacity, or the necessary expertise, to manage the business prudently.

The supervisor should require **insurers with overseas establishments** to maintain a sound and verifiable system of reporting from those establishments to head office.

In all the above situations the supervisor should readily exchange information with other supervisors involved, to accept on site inspections of branches of foreign insurers in his jurisdiction, and to have the ability to run independent checks on data provided by individual foreign establishments.

Principle 16 - Coordination and Cooperation.

Increasingly, insurance supervisors liaise with each other to ensure that each is aware of the other's concerns with respect to an insurance company that operates in more than one jurisdiction either directly or through a separate corporate entity.

In order to share relevant information with other insurance supervisors, adequate and effective communications should be developed and maintained.

In developing or implementing a regulatory framework, consideration should be given to whether the insurance supervisor:

- is able to enter into an agreement or understanding with any other supervisor both in other jurisdictions and in other sectors of the industry (i.e. insurance, banking or securities) to share information or otherwise work together;
- is permitted to share information, or otherwise work together, with an insurance supervisor in another jurisdiction. This may be limited to insurance supervisors who have agreed, and are legally able, to treat the information as confidential;
- should be informed of findings or investigations where power to investigate fraud, money laundering and other such activities rests with a body other than the insurance supervisor; and
- is permitted to set out the types of information, as well as the basis on which information obtained by the supervisor may be shared.

Guidelines.

The supervisor should be able to discuss the affairs of any entity licensed under the insurance law with any other supervisor, insurance or otherwise, in any other jurisdiction on a confidential basis. (For most OGIS members this will not extend to other jurisdiction's tax authorities.) This means that:

1. The supervisor should have the authority to exchange confidential information with insurance supervisors in other jurisdictions with such confidentiality being legally protected, onward transmission of information received normally being subject to the consent of the provider. Any action contemplated arising from information so received should, where possible, be discussed with the other supervisor(s) concerned. The supervisor should also be able to obtain information on behalf of a supervisor in another jurisdiction, and otherwise cooperate with him.
2. The supervisor should have the ability to exchange information with supervisors of other financial services both within and without his jurisdiction.
3. Where powers to investigate fraud, money laundering and other such activities rest with some other body the supervisor should be informed of such investigations and any findings therefrom.
4. As supervisor of a parent insurer with foreign establishments the supervisor should inform the host supervisors of those establishments of any material changes in supervision which may have a significant bearing on the operation of such establishments.
5. As supervisor of a parent insurer the supervisor should take the host supervisor into confidence as much as possible, where he has doubts about the standard of that supervision and in consequence envisages action which will affect the foreign establishment in the jurisdiction concerned he should consult the host supervisor in advance.
6. The supervisor should be able to enter into agreements or understandings with any other supervisor, both in other jurisdictions and in other sectors of the financial services industry, he should also be able to set out the types of information and basis upon which information so obtained may be shared.

Principle 17 - Confidentiality.

All insurance supervisors should be subject to professional secrecy constraints in respect of information obtained in the course of their activities, including during the conduct of on-site inspections.

The insurance supervisor is required to hold confidential any information received from other supervisors, except where constrained by law or in situations where the Insurance supervisor who provided the information provides authorisation for its release.

Jurisdictions whose confidentiality requirements continue to constrain or prevent the sharing of information for supervisory purposes with insurance supervisors in other jurisdictions, and jurisdictions where information received from another supervisor cannot be kept confidential, are urged to review their requirements.

Guidelines.

This principle is inextricably bound up with the previous one, full coordination and cooperation cannot be effective without confidentiality. The last paragraph of the above is therefor particularly important.

1. There should be a professional secrecy requirement enshrined in the law of the jurisdiction (either the insurance law or other laws which may apply to the conduct of the insurance supervisor). "Gateway" provisions should clearly set out the ability of the supervisor to pass confidential information to other supervisors or law enforcement bodies.
2. Freedom of information provisions should not, generally, override the professional secrecy requirement to which the insurance supervisor is subject.
3. The supervisor should be able to hold as confidential any information received from a supervisor in another jurisdiction

Guidelines To Compliance.

Annex One.

Suggested core elements of a **business plan** for a new **captive insurer**:

- a narrative setting out the ownership, other parties involved such as business producers, fronting insurers, the risks to be insured (in general) and the perceived benefits of the proposal to all the parties mentioned,
- a full description of the risks to be insured, with exposures fully quantified;
- a full description of any outwards reinsurance programme (reinsurers and exposures to be assumed);
- the proposed capital (amount and in what form);
- past insurance history (premiums and claims) of the risks to be insured;
- financial projections (including solvency margins) for at least three years ahead; and
- a description of the investment policy, with names of any outside investment advisors/managers.

Guidelines to Compliance

Annex Two.

Suggested core elements of a **business plan** for a new **domestic insurer**:

- a narrative setting out the ownership and the broad business intent,
- the proposed capital (amount and in what form);
- a more specific outline of the lines of business and planned exposures;
- any outwards reinsurance programme (reinsurers and exposures to be assumed);
- the marketing strategy (direct writing / brokers / agency force);
- financial projections (including solvency margins) for at least three years ahead;
- a description of the investment policy, with names of any outside investment advisors/managers; rating structure and claims management procedures;
- a description of the corporate governance principles and the way in which they are to be followed through, and
- a commentary on proposed internal controls.

Guidelines to Compliance

Annex Three.

Check list of areas to be covered by the supervisor in dealing with **Internal Controls**. (An abridged version of the essential criteria found under Principle 5, Internal Controls.)

Does the supervisor have the authority to:

- review the internal controls, determine their adequacy and request strengthening where necessary,
- require a board of directors to provide suitable prudential oversight of standards (underwriting, setting reserves, investment and coinsurance);
- require a board to provide suitable oversight of market conduct activities (standards, customer treatment/disclosure, conflicts of interest etc.),
- require internal controls to address issues of an organisational structure (duties, delegation of authorities, separation of critical functions such as new business, accounting and compliance);
- require internal controls to address accounting procedures and information for management;
- require internal controls to address checks and balances (segregation of duties, control of assets etc.);
- require controls on the safeguarding of assets and investments;
- require the insurer have an on-going audit function appropriate to the nature and size of the business and which has;
 - unfettered access to all business lines and departments;
 - appropriate independence and status to ensure recommendations are acted upon;
 - sufficient resources;
 - a methodology that identifies key risks run by the institution and allocates its resources accordingly;
- require insurers have formal procedures to recognise potential suspicious transactions,
- require insurers to have established lines of communication both to management, law enforcement authorities and/or the **insurance supervisor for the reporting of irregular** and suspicious activities.