

# **OFFSHORE GROUP OF INSURANCE SUPERVISORS**



**PRINCIPLES PAPER  
OCTOBER 2001**

**LOANS TO RELATED PARTIES**

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## *PRINCIPLES PAPER*

### Loans to Related Parties

#### **Introduction**

1. For the purpose of this Paper, Loans to Related Parties are –
  - loans to the parent, or within the parent group;
  - loans to directors or controllers of the insurer or to their relatives;
  - made by an insurance entity licensed within the domicile or, by a cell within a licensed Protected Cell Company (and its equivalents) or, an account within a licensed Rent-a-Captive (hereafter all referred to as “licensed insurer”).
2. The law and practice of each domicile will determine to what extent such loans should be permitted and counted as Approved Assets of the licensed insurer for the purposes of calculating margins of solvency.

#### **General**

3. As a general, prudent, principle the Supervisor should require **that a licensed insurer should at all times have ready access to funds to meet its liabilities**, thus ensuring that the licensed insurer can always meet its obligations.
4. The Supervisor should require that loans to related parties are not made by a licensed insurer except with his prior agreement.
5. Before giving his agreement, the Supervisor should determine the reason for making the loan. The Supervisor may be able to give his agreement if the licensed insurer (or its parent group) can demonstrate a genuine wish to increase the rate of return on the asset through employment of these funds within the parent group at a higher rate of return.
6. To satisfy himself that the parent group does not require funds because it is suffering from a liquidity shortage, the Supervisor should review the latest accounts, credit rating and other financial information concerning the parent group.
7. In reviewing applications for permission to make loans, the Supervisor should distinguish between –
  - funds required by a licensed insurer to meet its insurance liabilities (notified and IBNR), including funds required to meet the Margin of Solvency;
  - funds surplus to the above.

Other than the comments below concerning spread of investment and rate of return, a Supervisor may, if requested, permit a proportion of a licensed insurer’s **surplus**

**assets**, or in exceptional circumstances all its surplus assets, to be lent to the parent, provided that the Supervisor is satisfied with the insurer's reserving policy. In some respects, such free funds may be regarded as no more than undeclared dividends.

8. The Supervisor may wish to permit loans of funds that are required to meet insurance liabilities, provided the parent is of a designated minimum credit rating or has a minimum acceptable net asset value. In effect, the Supervisor is permitting the licensed insurer to take a controlled credit risk.
9. In making any loans, the directors of the licensed insurer should ensure that they are placed on normal economic terms, that is closely related to the usual –
  - market rates for the perceived risk exposure
  - length of term for that type of investment;
  - cancellation / repayment terms.
  - adequacy and appropriateness of security.

An interest-free loan with no repayment terms should not be regarded as a prudent investment.

### **Parent Group**

10. In assessing whether or not loans should be regarded as Approved Assets, the Supervisor should take into consideration the credit rating of the parent group. It can be argued that since a Supervisor permits reinsurance placements as reducing the solvency requirements of a licensed insurer and that he regards as Approved Assets deposits with banks and investments in corporate bonds and equities, all on the basis of acceptable minimum credit ratings, then he may be justified in permitting a licensed insurer to make loans to its parent group, provided the credit rating of the parent is acceptable.
11. Where the loan is to be made to a fellow subsidiary of the licensed insurer, rather than to the parent, the Supervisor should request evidence that the fellow subsidiary will be financially supported by the common parent.
12. Where the parent group is a regulated financial institution such as a bank (perhaps regulated in another jurisdiction), the Supervisor may be content to permit the licensed insurer to place deposits with its parent, on normal commercial terms.
13. Before permitting a licensed insurer to make loans to its parent that is a regulated institution, the Supervisor should inform and seek the agreement of the supervisor of the parent.
14. The Supervisor may be reluctant to permit loans from a licensed insurer to a parent that is an insurance company, because of his perception that this may create a situation of double-gearing or double-exposure, through both companies sharing in the same risk.
15. Where a licensed insurer has written policies direct to its parent, it may be that a written, agreed, offset of loans against insurance liabilities can be created (subject to

the laws of the country of the parent and the domicile of the licensed insurer). In such a case, the Supervisory may wish to permit a licensed insurer to lend underwriting funds to its parent. However, where these policies involve third party claimants (eg employees or customers) who are relying on the insurance cover, the Supervisor should ensure that these claimants are fully protected, before permitting any loan.

16. Where a licensed insurer has written its parent's business as a reinsurance from a third party "market" insurer, it should be borne in mind that the licensed insurer's legal obligation under the policy is to that third party insurer. In that context, delayed receipt of (or uncollectable) loans to the parent, that represent underwriting (rather than surplus) funds, may precipitate legal action from the third party insurer.