INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS

Public

Insurance Core Principles and Common Framework for the Supervision of Internationally Active Insurance Groups

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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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History

The Insurance Core Principles (ICPs) were adopted on 1 October 2011. Since then, amendments have been made to various individual ICPs, the most recent being:

- ICPs 4, 5 and 23 — November 2015
- ICPs 13, 18 and 19 — November 2017
- ICP 6 — November 2018
- ICP Introduction and Assessment Methodology and ICPs 1, 2, 3, 7 8, 9, 10, 12, 15, 16, 20, 22, 24, 25 — November 2019

Former ICP 11 (Enforcement) has been merged with ICP 10. Therefore, there is no longer an ICP 11; however to avoid confusion, the existing numbering of other ICPs has not changed.

The Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame) was adopted in November 2019. ComFrame is presented in blue boxes within the ICP Introduction and Assessment Methodology as well as within the following ICPs: 5, 7, 8, 9, 10, 12, 15, 16, 23 and 25.

The IAIS Glossary has been revised in November 2019, except for terms related to ICPs 14 and 17. These terms will be revised together with the revision of ICPs 14 and 17, which will commence after the agreement of the ICS Version 2.0 for the monitoring period.

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Acronyms

ALM	Asset-liability management
AML	Anti-money laundering
CDD	Customer due diligence
CFT	Combating the financing of terrorism
ComFrame	Common Framework for the Supervision of Internationally Active Insurance Groups
ERM	Enterprise Risk Management
FATF	Financial Action Task Force
FIU	Financial intelligence unit
IAIG	Internationally Active Insurance Group
IAIG CMG	Crisis management group of the Internationally Active Insurance Group
ICP	Insurance Core Principle
ICS	Insurance Capital Standard
IDR	Independent Dispute Resolution
IFRS	International Financial Reporting Standards
IGT	Intra-group transactions
IL	Insurance liability
MCR	Minimum Capital Requirement
MIS	Management information system
ML	Money laundering
MMoU	Memorandum of Understanding
MOCE	Margin Over the Current Estimate
NCWOL	No creditor worse off than in liquidation
NRA	National Risk Assessment
ORSA	Own Risk and Solvency Assessment
PCR	Prescribed Capital Requirement
PPS	Policyholder Protection Scheme
RBA	Risk-Based Approach
SPE	Special Purpose Entity
SRO	Self-regulatory organisation
TF	Terrorist financing
TVaR	Tail value at risk
VaR	Value at risk

Introduction and Assessment Methodology

A) Introduction

1. Established in 1994, the International Association of Insurance Supervisors (IAIS) is a voluntary membership organisation of insurance supervisors and regulators from around the globe. It is the international standard-setting body responsible for developing and assisting in the implementation of supervisory and supporting material for insurance supervision. The IAIS also provides a forum for members to share their experiences and understanding of insurance supervision and insurance markets.

2. 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. In this context, the IAIS has issued the Insurance Core Principles (ICPs), which are comprised of Principle Statements, Standards and Guidance, as a globally accepted framework for insurance supervision. The ICPs seek to encourage the maintenance of consistently high supervisory standards in IAIS member jurisdictions. A sound supervisory system is necessary for the protection of policyholders and promoting the stability of the financial system and should address the broad set of risks within, and posed by, the insurance sector.

Structure

3. The ICP material is presented according to the following hierarchy:

   - Principle Statements – the highest level in the hierarchy which set out the essential elements that must be present in a jurisdiction in order to protect policyholders, promote the maintenance of fair, safe and stable insurance markets and contribute to financial stability. In each ICP, the Principle Statement is numbered and presented in a box with bold font.

   - Standards – the next level in the hierarchy linked to specific Principle Statements. Standards set out key high-level requirements that are fundamental to the implementation of the Principle Statement and should be met for a jurisdiction to demonstrate observance with the particular Principle Statement. Standards are presented in bold font, with the number of the applicable principle statement followed by the Standard number (for example, the second standard under Principle Statement 3 appears as 3.2).

   - Guidance – the lowest level in the hierarchy supporting the Principle Statement and/or Standards. Guidance facilitates the understanding and application of the Principle Statement and/or Standards; it does not represent any requirements. The wording used in Guidance varies to reflect the intended weight of the text; for example, the use of “should” provides more of a recommendation, whereas the use of “may” is more of a suggestion. Where appropriate, Guidance provides examples of ways to implement the Principle Statements and/or Standards. Guidance is presented in regular font, with the number of the Principle Statement and Standard followed by the Guidance number (for example, the first paragraph of guidance under Standard 3.2 appears as 3.2.1).

Overarching Concepts

4. There are a number of important overarching concepts to understand and keep in mind when reading and implementing the ICPs. While an individual ICP may focus on one particular subject, the ICPs need to be considered as a whole with these overarching concepts being relevant throughout.

Applicability

5. The ICPs apply to insurance supervision in all jurisdictions regardless of the level of development or sophistication of insurance markets, and the type of insurance products or services being supervised.
6. 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.
7. Generally, the ICPs are equally applicable to the business of insurers and reinsurers. Where the ICPs do not apply to reinsurers, this is indicated in the text.
8. The ICPs only apply to the supervision of intermediaries where this is specifically indicated.

Proportionality and risk-based supervision

9. The ICPs establish the minimum requirements for effective insurance supervision and are expected to be implemented and applied in a proportionate manner. Therefore, proportionality underlies all the ICPs. Supervisors have the flexibility to tailor their implementation of supervisory requirements and their application of insurance supervision to achieve the outcomes stipulated in the Principle Statements and Standards.
    - Implementation - proportionality allows the ICPs to be translated in to a jurisdiction's supervisory framework in a manner appropriate to its legal structure, market conditions and consumers.
    - Application - proportionality allows the supervisor to increase or decrease the intensity of supervision according to the risks inherent to insurers, and the risks posed by insurers to policyholders, the insurance sector or the financial system as a whole. A proportionate application involves using a variety of supervisory techniques and practices which are tailored to the insurer to achieve the outcomes of the ICPs. Such techniques and practices should not go beyond what is necessary in order to achieve their purpose.
10. Risk-based supervision is a related concept but distinct from proportionality; it means more supervisory activities and resources are allocated to insurers, lines of business or market practices that pose the greatest risk to policyholders, the insurance sector, or the financial system as a whole.

Terminology

11. In these ICPs, terms have the same meaning as set out in the IAIS Glossary.
12. The term "supervision" is used to refer to supervision and regulation. Similarly, the term "supervisor" also refers to "regulator". The expectation is that the Principle Statements and Standards are implemented within a jurisdiction by all authorities in accordance with their respective responsibility in relation to insurance supervision, rather than necessarily by only one authority. Therefore, the term "supervisor" is used to refer collectively to those authorities within a jurisdiction with such responsibility. It is essential that in situations where multiple authorities exist, arrangements be established between them to ensure that the implementation of the Principle Statements and Standards within the jurisdiction occurs within a framework that makes clear which authority is accountable for which functions.

13. The term “policyholder” is used to refer to a person (natural or legal) who holds an insurance policy, and includes, where relevant, other beneficiaries and claimants with a legitimate interest in the policy.

14. The term “legislation” is used to include primary legislation (which generally requires full legislative consent), secondary legislation and legally enforceable rules set by the supervisor. The ICPs do not generally require a specific form of legislation but where they do this is specifically indicated.

15. The term “insurer” means insurance legal entities and insurance groups, including insurance-led financial conglomerates. The Principle Statements and Standards apply to the supervision of insurance legal entities and, unless otherwise specified, to insurance groups, including the head of the insurance group. The application may vary and, where necessary, further guidance is provided.

Group-Wide Supervision

16. It is recognised that the implementation of the Principle Statements 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 legal entities in the insurance group and can impose relevant supervisory measures directly on such legal entities, including non-regulated legal 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 legal entities.

    There may also be different combinations of elements of direct and indirect approaches.

17. Regardless of the approach, the supervisor must be able to deliver effective group-wide supervision, including that all relevant group-wide risks impacting the insurance entities are addressed appropriately.

Group corporate governance and materiality

18. The head of an insurance group is ultimately responsible for the group’s sound and prudent management. In doing so, it is important to take into account the risks and activities of the individual legal entities within the group, focusing in particular on those which are material for the group as a whole.

19. While the ultimate responsibility for an insurance group’s corporate governance lies with the head of the group, the legal entities within the group are fully responsible for their own sound and prudent management.

ComFrame Introduction

20. In the context of its mission, the IAIS has issued the Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame), which establishes supervisory standards focusing on the effective group-wide supervision of internationally active insurance groups (IAIGs).

21. ComFrame provides quantitative and qualitative supervisory minimum requirements tailored to the international activity and size of IAIGs. ComFrame seeks to assist supervisors in: addressing group-wide activities and risks; identifying and avoiding

supervisory gaps; coordinating supervisory activities efficiently and effectively between the group-wide and other involved supervisors. ComFrame also aims to provide a basis for comparing IAIG supervision across jurisdictions. However, it does not create a one-size-fits all approach to IAIG supervision as, ultimately, what is important is that supervisors and IAIGs achieve the outcomes described by ComFrame.

22. As part of ComFrame, the IAIS is developing an insurance capital standard (ICS), which aims to provide a globally comparable risk-based measure of capital adequacy of IAIGs. ICS Version 2.0 is presented in a stand-alone document and is being used during a five-year monitoring period for confidential reporting to group-wide supervisors and discussion in supervisory colleges. The ICS is not used as a group-wide Prescribed Capital Requirement (PCR) during the monitoring period. In the second phase of implementation of ICS Version 2.0, the ICS will be implemented as a group-wide PCR.

Structure

23. The ICPs are applicable to the supervision of all insurers within a jurisdiction, which includes IAIGs. ComFrame provides additional Standards and Guidance applicable only to the supervision of IAIGs. The qualitative requirements of ComFrame material is presented in blue boxes within the relevant ICP material, following a similar hierarchy to the ICPs:

    - ComFrame Standards – the highest level in the ComFrame hierarchy which build on certain ICP Principle Statements and/or ICP Standards. ComFrame Standards are outcomes-focused, specific requirements for supervisors. ComFrame Standards are presented in bold font, and follow the numbering of the relevant ICP Principle Statement and/or ICP Standard with the addition of "CF" and a letter (for example, the second ComFrame Standard under ICP Standard 7.2 would appear as CF 7.2.b).
    - ComFrame Guidance – the lowest level in the ComFrame hierarchy which provides support for ComFrame Standards. ComFrame Guidance is intended to facilitate the understanding and application of a ComFrame Standard; it does not represent any requirements. Where appropriate, ComFrame Guidance provides examples of ways to implement a ComFrame Standard. ComFrame Guidance is presented in regular font, with the number and letter of the ComFrame Standard followed by the ComFrame Guidance number (for example, the first paragraph of ComFrame Guidance under ComFrame Standard CF 7.2.b would appear as CF 7.2.b.1).

Overarching Concepts

24. The overarching concepts identified in the ICP Introduction are equally applicable to ComFrame, in particular proportionality. Additionally, there are several, ComFrame-specific overarching concepts to understand and keep in mind when reading and implementing ComFrame.

Allocation of roles

25. The group-wide supervisor takes responsibility for the supervision of the IAIG as a whole, on a group-wide basis. Other involved supervisors are responsible for the supervision of the IAIG's individual insurance legal entities in their respective jurisdictions and take into account the effect of their supervisory actions on the rest of the IAIG.

Governance structures

26. IAIGs have different models of governance (ie more centralised or more decentralised). ComFrame does not favour any particular governance model and is intended to be read to apply to all models. The organisation of an IAIG can be structured in various ways as long as the outcomes are achieved.

Group-Wide Supervision

27. Similar to the ICPs, ComFrame, for the most part, is neutral as to direct or indirect approaches to group-wide supervision, so long as the intended outcomes of the group-wide supervision are achieved. Where ComFrame uses a direct approach for certain powers, it is indicated in the relevant ComFrame Standards.

B) Assessment Methodology

28. The IAIS strongly encourages implementation of the ICPs as a means to ensure each jurisdiction has a framework for effective insurance supervision. Assessment of a jurisdiction's observance of the ICPs can facilitate effective implementation by identifying the extent and nature of strengths and weaknesses in a jurisdiction's supervisory framework – especially those aspects that could affect policyholder protection and financial stability.

29. The framework described by the ICPs is general. When implementing the ICPs in a jurisdiction, it is important to take into account the domestic context, characteristics of the insurance sector and developmental stage of the financial system and overall macroeconomic conditions. How the ICPs are implemented will vary across jurisdictions. While established implementation practices should be kept in mind, there is no mandated method of implementation. When carrying out an assessment, it is important to take into account factors that have shaped the implementation choices made in the jurisdiction.

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

- self-assessments performed by the jurisdiction itself. These may be performed with the assistance of outside experts and/or followed by peer review and analysis;
- reviews conducted by third parties; or
- reviews in the context of the Financial Sector Assessment Program (FSAP) conducted by the International Monetary Fund (IMF) and World Bank.

31. The methodology that should be followed when carrying out an assessment of a jurisdiction's observance of the ICPs is set out below. Following the methodology should result in greater consistency between assessments, especially assessments of different jurisdictions performed by different assessors. While the results of an assessment may not always be made public, it is still important for their credibility that similar types of assessments are conducted in a broadly uniform manner from jurisdiction to jurisdiction.

Scope of assessments

32. An assessment may be conducted on a system-wide jurisdictional basis or focus on specific areas. While thematic assessments have a role, the IAIS has designed the ICPs as a comprehensive and holistic framework, with each ICP being integral in the creation of a sound supervisory system.

33. Where more than one authority is involved in a jurisdiction's insurance supervision process, the allocation and interaction of supervisory roles should be clearly described in the assessment. If an assessment is conducted in the context of an individual authority within a jurisdiction, a Standard may be not applicable if responsibility (either for its implementation or its delivery on a day-to-day basis) lies with another authority within that jurisdiction. However, the authority responsible for the observance of that Standard should be indicated in the report.

34. The ICPs are written to be equally applicable to both life and non-life sectors. However, where there are material differences between the life and non-life sectors, such that it would give rise to different results had they been assessed separately, the assessor may consider assigning separate levels of observance for each sector accordingly. In such cases, the distinction should be clearly identified and explained in any assessment report.

Use of experts

35. The process of assessing observance of the ICPs requires a judgmental weighing of numerous elements. It is important, therefore, that assessors are well qualified with relevant background, professional knowledge and practical experience. Assessors not familiar with insurance supervision, the insurance sector or entities and products that may be unique to the jurisdiction being assessed, could come to incorrect or misleading conclusions.

Access to information

36. When conducting an assessment, assessors need to have access to a range of information and people. The required information may include published information (such as the legislation and administrative policies) as well as non-published information (such as self-assessments performed and operational guidelines used by the supervisor). The supervisor may provide confidential information to the assessors, provided confidentiality is preserved. Information should be provided to and analysed by the assessors in advance, to the extent possible, to ensure that any on-site visits are efficient and derive the most value. The assessors may need to meet with various individuals and organisations, including the supervisor, other domestic supervisory authorities, relevant government ministries, insurers and insurance industry associations, consumer groups, actuaries, auditors, and other financial sector participants.

Assessment process

37. Assessments should be based solely on the legislation and supervisory practices that are in place at the time. As a result, it is important to recognise when an assessment is conducted and to record this in the report. Nevertheless, improvements already proposed or scheduled for implementation by the supervisor should be noted in the assessment report by way of additional comments so as to provide recognition for efforts that are important, but not yet fully implemented. Additionally, the assessment should consider whether supervisory practices adequately meet the outcomes provided for in legislation and whether the supervisor enforces compliance. Having legislation without the necessary corresponding supervisory practices is not sufficient to demonstrate full observance.

38. Performing an assessment is not an exact science. Assessors should perform a comprehensive assessment of the degree and effectiveness of implementation for each Principle Statement and Standard rather than a checklist approach. The goal of the assessment should not be simply to apply a grade to the level of observance but to

identify areas that need attention in order for the jurisdiction to achieve the outcomes identified in the ICPs.

Assessment of Standards

39. The Standards set requirements that are fundamental to the implementation of each Principle Statement. They also facilitate assessments that are comprehensive, precise and consistent. In making an assessment, each of the Standards under a Principle Statement has to be considered. As noted in the ICP Introduction, Guidance is intended to facilitate the understanding and application of the Principle Statement and/or Standard and does not prescribe any requirements, therefore it should not be assessed for observance.

40. The Standards should be assessed using five categories:

- **Observed** – for a Standard to be considered observed it is necessary that the supervisor has and exercises, when required, the legal authority and supervisory practices to effectively perform the requirements of the Standard. Having legislation without supervisory practices to implement a Standard is insufficient to be considered observed, except for those Standards that are specifically focused on legislation itself and what it contains. For supervisory practices which may lack explicit legal authority, the assessment should be considered as observed if the practice is clearly substantiated by the supervisor and is generally accepted by stakeholders. Having the necessary resources is essential for the supervisor to implement Standards effectively.
- **Largely observed** – 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 and intent to achieve full observance with the Standard within a prescribed period of time. The assessment of largely observed can be used when the jurisdiction does not meet all the criteria, but the overall effectiveness is sufficiently good and no material risks are left unaddressed.
- **Partly observed** – for a Standard to be considered partly observed, there are sufficient shortcomings to raise doubts about the supervisor's ability to achieve observance.
- **Not observed** – for a Standard to be considered not observed, there is no substantive progress toward achieving observance.
- **Not applicable** – for a Standard to be considered not applicable, the Standard does not apply given the structural, legal and institutional features of a jurisdiction.

Assessment of Principle Statements

41. As noted above, the level of observance for each Principle Statement reflects the assessments of its Standards. The Principle Statements should be assessed using five categories:

- **Observed** – for a Principle Statement to be considered observed, all the Standards must be considered observed (except any Standards that are considered not applicable).
- **Largely observed** – for a Principle Statement 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 Principle Statement.

- **Partly observed** – for a Principle Statement to be considered partly observed, there are sufficient shortcomings to raise doubts about the supervisor's ability to achieve observance.
- **Not observed** – for a Principle Statement to be considered not observed, there is no substantive progress toward achieving observance.
- **Not applicable** – for a Principle Statement to be considered not applicable, all the Standards must be considered not applicable.

Reporting

42. The IAIS does not prescribe a set format or content of reports that result from an assessment. However, it is recommended that an assessment report should:
    - be in writing;
    - identify the scope and timing of the assessment;
    - identify the assessors;
    - provide an assessment of observance;
    - refer to the information reviewed and meetings conducted, and note when any necessary information was not provided and the impact that this may have had on the accuracy or completeness of the assessment;
    - include any formal comments provided by the supervisor in response to the assessment; and
    - include prioritised recommendations for improving observance of the ICPs assessed.
43. While encouraged, it is the jurisdiction's discretion whether to publish the results of an assessment. Nevertheless, it is important for the credibility of assessments that they are conducted in a broadly uniform manner across jurisdictions.

ComFrame Assessment Methodology

44. As with the ICPs, the IAIS strongly encourages implementation of ComFrame as a means to ensure that jurisdictions to which ComFrame is applicable have a framework for effective supervision of IAIGs. In general, the assessment methodology described for the ICPs is applicable to ComFrame. However, given the nature of ComFrame, which provides quantitative and qualitative supervisory requirements tailored to the international activity and size of IAIGs, there are some additional considerations that should be taken into account when assessing observance of ComFrame requirements.

Role of involved supervisors

45. ComFrame seeks to assist supervisors in coordinating supervisory activities efficiently and effectively between the group-wide and other involved supervisors, thus a number of ComFrame Standards address coordination. However, it is recognised that having efficient and effective coordination depends on all involved supervisors. The group-wide supervisor relies on the other involved supervisors to do their part and vice versa. Where there are shortcomings with an involved supervisor doing their part for coordination, there are limits to what the other supervisors can do to improve the situation. When assessing parts of ComFrame that focus on coordination, this should be taken into account.

46. The type of assessment of a jurisdiction's implementation of ComFrame will depend on whether, in that jurisdiction, there is: a group-wide supervisor of an IAIG; an other involved supervisor; or both. Most ComFrame Standards are addressed to the group-wide supervisor and describe the outcomes they are expected to achieve, whereas some ComFrame Standards also include the other involved supervisors. Therefore, an assessment of a jurisdiction's implementation of ComFrame should reflect the role it has in the supervision of an IAIG. A jurisdiction where there is only an other involved supervisor will not be assessed on the implementation of ComFrame Standards that are addressed only to the group-wide supervisor.

47. For ComFrame Standards that are addressed to both the group-wide supervisor and other involved supervisors, the assessment of those Standards should be based on the role of the jurisdiction's supervisor. An assessment of a group-wide supervisor jurisdiction should focus on whether it has put in place the necessary legislation and supervisory practices for coordination with the other involved supervisors, whereas an assessment of an other involved supervisor jurisdiction would focus on its role within this context (for example, coordinating with the group-wide supervisor on processes, exchanging information).

Reporting

48. Involved supervisors are encouraged to share the results of an assessment within the supervisory college for information.

Assessment process

49. As some ComFrame Standards focus on coordination and information exchange between the group-wide supervisor and other involved supervisors, in demonstrating observance of such Standards there may be more emphasis on supervisory practices rather than legislation. While legislation provides the authority to coordinate and exchange information, the supervisor, more importantly, needs to have appropriate supervisory practices for coordination in place that facilitate effective supervision of an IAIG.

Interaction with assessments of ICPs

50. The ICPs are applicable to the supervision of all insurers within a jurisdiction, which includes IAIGs. ComFrame provides additional Standards and Guidance applicable only to the supervision of IAIGs. As the ICPs provide the necessary foundation for ComFrame, an assessment of ComFrame Standards cannot be done in isolation. It should be determined in advance of an assessment whether the level of observance of ComFrame Standards is included when assessing the level of observance of the relevant Principle Statements within the ICPs or whether an assessment of the level of observance of ComFrame Standards is treated separately.

Preconditions for effective insurance supervision

51. An effective system of insurance supervision requires a number of preconditions to be in place, as they can have a direct impact on supervision in practice. An assessment of a jurisdiction's observance of the Principle Statements and Standards may involve a review of preconditions for effective insurance supervision.

52. This section provides a number of categories of preconditions and descriptions of how each precondition may be reviewed. 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; and
- efficient financial markets.

53. As these preconditions are normally outside the control or influence of the supervisor, and because they are beyond the scope of the ICPs, an assessment should not evaluate a jurisdiction's observance of the preconditions. Instead, the objective of a review of preconditions is to help inform an assessment of observance of the ICPs because the preconditions can directly impact the effectiveness of supervision. Where shortcomings exist, the supervisor should make its government aware of these and their actual or potential repercussions for the achievement of supervisory objectives and seek to mitigate the effects of such shortcomings on the effectiveness of supervision.

54. Any report on a review of preconditions should:

- be descriptive and not express an opinion on the adequacy of policies in these areas, other than through reference to analyses and recommendations in existing official documents;
- include an analysis of the linkages between these factors and the resilience of the insurance sector, when relevant;
- give a clear picture of the adequacy of the preconditions within the jurisdiction and the interaction of the preconditions with the assessment of observance with the ICPs; and
- flag any individual ICPs which are most likely to be affected by any material weakness in the preconditions.

Sound and sustainable macroeconomic and financial sector polices

55. Sound macroeconomic policies are 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.

56. A review of this precondition should 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.

Well-developed public infrastructure

57. A well-developed public infrastructure contains the following elements which, if not adequately provided, can contribute to the weakening of the financial system 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;

- use of 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;
- access to 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.

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

Effective market discipline in financial markets

59. 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 investors are not insulated from the consequences of their decisions. Among issues to be addressed are the existence of appropriate corporate governance frameworks and ensuring that accurate, meaningful, transparent and timely information is provided by issuers and borrowers to investors and creditors.
60. A review of the effectiveness of market discipline could 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; and
    - an effective framework for new entrants, mergers, takeovers, and acquisition of equity interests, including those involving foreign entities.

Mechanisms for providing an appropriate level of policyholder protection

61. In general, deciding on the appropriate level of policyholder protection is a policy question to be addressed by each jurisdiction. Protection mechanisms could include, for example, a hierarchy of claims or a policyholder protection scheme. Provided such mechanisms are transparent and carefully designed to limit moral hazard, they can contribute to public confidence. For issues such as crisis management or the resolution of an insurer, the supervisor should have a role to play given its in-depth knowledge of the entities involved.

Efficient financial markets

62. Efficient financial markets are important to provide investment and risk management opportunities for insurers. Insurers benefit by having access to domestic and global financial markets.

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

ICP 1 Objectives, Powers and Responsibilities of the Supervisor

Each authority responsible for insurance supervision, its powers and the objectives of insurance supervision are clearly defined.

Introductory Guidance

1.0.1 Publicly defined objectives foster transparency. Based on this, government, legislatures and other stakeholders, including insurance industry participants and consumers, can form expectations about insurance supervision and assess how well the supervisor is achieving its objectives and fulfilling its responsibilities.

1.0.2 Responsibilities and objectives of the supervisor should be stable over time. However, when those responsibilities and objectives are updated periodically, it should be done in a manner that avoids creating instability, as a stable business environment is important for the insurance sector and consumer confidence. Objectives and key aspects of the supervisor responsibilities should be defined in primary legislation to the extent that it needs the effect of law. Aspects that should undergo frequent updating due to changing circumstances should be supplemented as needed with updated legally enforceable rules and guidance.

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

1.1.1 Primary legislation should clearly define responsibilities of each authority involved in insurance supervision at both the insurance legal entity level and the group-wide level.

1.1.2 Institutional frameworks for insurance supervision vary across jurisdictions. For example, there may be separate authorities for prudential and market conduct supervision, for macro and micro prudential supervision, for licensing and ongoing supervision, and resolution.

1.1.3 Where there are multiple authorities responsible for insurance supervision, the institutional framework, the main responsibilities of the respective authorities and a basis for cooperation and coordination should be clearly set out in primary legislation.

1.2 Primary legislation clearly determines the objectives of insurance supervision and these include at least to:

- **protect policyholders;**
- **promote the maintenance of a fair, safe and stable insurance market; and**
- **contribute to financial stability.**

1.2.1 The precise supervisory objectives and their respective priority may vary by jurisdiction depending on the level of development of the insurance markets, market conditions and consumers. Supervisory objectives could also include promoting insurance market development, financial

inclusion, financial consumer education, and contributing to fighting financial crime.

1.2.2 The policyholders to be considered in defining supervisory objectives include past, present and future policyholders.

1.2.3 Depending on the evolution of the jurisdiction's insurance or financial markets, the supervisor may emphasise temporarily one or more of the objectives. Regardless, the supervisor should take into account the other objectives in fulfilling its function. In such circumstances, this should be explained to stakeholders, including insurance industry participants, consumers and the general public.

1.3 Primary legislation gives the supervisor adequate powers to meet its responsibilities and objectives.

1.3.1 Primary legislation should give the supervisor the necessary powers to achieve its responsibilities and objectives, and the ability to take supervisory action adequately. The supervisor should have the powers needed to implement a framework for effective insurance supervision, which is described by the ICPs in general.

1.3.2 Legislation should clearly address insurance legal entity and group-wide supervision, providing the supervisor with sufficient powers to achieve the respective responsibilities and objectives.

1.3.3 The supervisor should have sufficient powers in place to perform the role of a group-wide supervisor, including coordination and collaboration with other relevant supervisors. Additionally, the legislation should empower the supervisor of an insurance legal entity which is part of a group to contribute to the supervision of that group on a group-wide basis.

1.4 The supervisor initiates or proposes changes in legislation where current responsibilities, objectives or powers are not sufficient to meet the intended supervisory outcomes.

1.4.1 It is important that supervisory responsibilities, objectives and powers are aligned with actual challenges faced by the insurance market to effectively protect policyholders, maintain a fair, safe and stable insurance market and contribute to financial stability.

1.4.2 Market changes can mean that the legislation is no longer adequate for the supervisor to achieve its intended outcomes. The supervisor may identify changes in the economy, society or business environment in general that affect insurance supervisions that are not currently or sufficiently addressed by legislation. When the supervisory outcomes may not be achieved with the current legislation, the supervisor should initiate or propose changes in legislation.

1.4.3 If supervisory responsibilities, objectives or powers assigned by primary legislation become obsolete, the supervisor should initiate or propose changes to the legislation.

ICP 2 Supervisor

The supervisor is operationally independent, accountable and transparent in the exercise of its responsibilities and powers, and has adequate resources to discharge its responsibilities.

Introductory Guidance

2.0.1 Operational independence, accountability and transparency by the supervisor contribute to the legitimacy and credibility of the supervisory process. As explained in this introductory guidance, the three concepts of independence, accountability and transparency are closely interconnected and mutually dependent.

2.0.2 Operational independence means the supervisor should be able to take actions and make decisions in the exercise of its supervisory responsibilities without interference from any part of the government, including other governmental bodies, the legislature, and the insurance sector. The supervisor should be able to carry out the supervisory process, take supervisory measures and impose sanctions as it deems necessary to fulfil its objectives. However, this independence should be balanced with accountability.

2.0.3 The supervisor should be accountable for the actions it takes in the exercise of its supervisory responsibilities to the government, including other governmental bodies and the legislature, which delegated various responsibilities to the supervisor, as well as to those it supervises and the public at large. Accountability means that the supervisor operates within the bounds of its delegated authority, in a fair and equitable manner that is open to scrutiny and review by the government and the public, and that the actions of the supervisor may be challenged as part of a judicial appeal process. Strong internal governance processes, sufficient and skilled human resources and maintenance of high standards of integrity and professionalism underpin the accountability of the supervisor.

2.0.4 Transparency reinforces accountability. Transparency increases the predictability of supervision and shapes the expectations of supervised entities, which enhances supervisory effectiveness. For these reasons, supervisory requirements, supervisory processes as well as information about the supervisor's responsibilities should be publicly disclosed, in a manner consistent with any confidentiality requirements imposed on the supervisor.

2.0.5 The structures of supervisors vary across jurisdictions. For example, a supervisor can be structured as a separate independent entity governed by a Board of Directors, as a commission or as a body overseen by one appointed individual. No one single structure is appropriate for all supervisors. Regardless of their structure, all supervisors should have processes and safeguards that allow them to be operationally independent, accountable and transparent.

2.0.6 Given the differences in structures between supervisors, in this ICP, the "governing body" refers to the body of individuals that exercises

oversight of the supervisory organisation, such as a Board or commission, or in the case of a supervisor overseen by an appointed individual, to that individual. The "head of the supervisor" refers to the individual who is an employee of the supervisor and who leads the management team and exercises full management responsibility for the day-to-day functioning and decisions of the supervisor. The head of the supervisor may or may not also be a member of the governing body.

Independence

2.1 The supervisor is operationally independent and free from undue government or industry interference that compromises that independence.

2.1.1 Operational independence of the supervisor includes having the discretion to allocate its resources, including financial and human resources, and to carry out the supervisory process in accordance with its objectives and the risks the supervisor perceives. Having this discretion, which underpins operational independence, should be recognised in primary legislation.

2.1.2 The supervisor should be financed in a manner that does not undermine its independence. A wide variety of financing models exist, such as financing by government, levies imposed on supervised entities and combinations thereof. To help ensure the supervisor's independence is not compromised, the method in which it is financed should be stable, predictable and transparent, and prevent interference from its funding source.

2.1.3 The institutional relationships and accountability frameworks between the supervisor and the government should be clearly defined in legislation. It is important to specify the circumstances and processes for sharing information, consultation or approval between the supervisor and the government. This may 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. The daily operations of the supervisor should not be subject to consultation with or approval by the government. In exceptional circumstances, the supervisor may choose to consult with the government in relation to a supervisory decision where there are major socio-economic implications of that decision.

2.1.4 In addition to independence from the government, the supervisor should not permit excessively close relationships, or even the appearance thereof, with industry participants, in particular supervised entities. Such relationships can compromise the supervisor's ability to enforce the law strictly or to control the behaviour of supervised entities as intended by law. These relationships can also lead the supervisor to make policy or operational decisions to benefit supervised entities, whether a particular entity or supervised entities as a whole, rather than in furtherance of its supervisory objectives. The supervisor's policies, for example, post-employment, anti-corruption and accountability in decision-making, should seek to avoid such close relationships.

2.1.5 The legislation should define the responsibilities of the governing body. In cases where there are industry representatives or elected officials or government employees on the governing body of the supervisor, the

composition of the governing body should be sufficiently diverse to prevent such representatives from controlling the supervisor.

2.1.6 The supervisor's staff and members of its governing body can also experience pressures that could compromise their independence. Generally, the staff of the supervisor should not hold any consultancies, directorships or financial interests, expect any future benefit from, or be involved in any capacity in the entities it supervises, other than in a supervisory role or as a customer, and should not accept gifts or hospitality from these entities in excess of a low monetary value. The supervisor should have policies and processes or a code of conduct to avoid or manage real, potential or perceived conflicts of interests. The supervisor should require its staff and members of its governing body to report conflicts of interests. Staff and members of the governing body of the supervisor should exclude themselves from decisions where they have a conflict of interest.

2.2 Legislation governing the supervisor provides the necessary legal protection from legal action against the supervisor and its staff for actions taken in good faith while discharging their duties. In addition, the supervisor's staff is adequately protected against the costs of defending their actions.

2.2.1 Having necessary legal protection from legal action promotes the independence of the supervisor by enabling its staff to make decisions and take action against a regulated legal entity even though such action or decision may be contested by that entity.

2.2.2 In this context, legislation should protect the supervisor and its staff from criminal or civil liability for decisions made and actions taken in the course of discharging their supervisory responsibilities, provided that the action or decision was not taken in bad faith or illegally.

2.3 Procedures regarding the appointment and dismissal of the head of the supervisor and members of its governing body (if such a governing body exists) are transparent.

2.3.1 Public procedures regarding the appointment and dismissal of the head of the supervisor enhance independence, as they limit the potential for government interference in the management of the supervisor. Those procedures should be codified in legislation.

2.3.2 Those procedures should disclose, for example, who appoints the head of the supervisor and members of the governing body, the length of those appointments and the reasons for which the head of the supervisor or members of the governing body can be dismissed before the end of their term, if applicable.

2.3.3 Legislation should disclose the general criteria for appointing members of a governing body, including that they possess relevant qualifications, knowledge and experience to oversee the activities of the supervisor, as well as the mechanism for their remuneration (for example, salary, daily allowance or voluntary work). The procedures regarding the appointment of the members of the governing body should result in a balance of skills, knowledge and experience amongst the members of the governing body as a whole.

Accountability

2.4 The supervisor has effective internal governance structures, processes and procedures to preserve the integrity of its actions and decisions and to enable it to account to its stakeholders.

2.4.1 A well-defined internal governance structure and strong internal governance processes support the accountability and integrity of the supervisor. The supervisor's internal governance includes its organisational structure and management arrangements, lines of responsibility, and systems of risk management and internal controls. In this context, integrity refers to the supervisor always acting with probity, respectability and lawfulness, and within the bounds of its delegated authority.

2.4.2 Regardless of the supervisor's governance structure, the responsibilities of the governing body, the responsibilities of Senior Management, communication channels and decision making authorities, including delegation thereof, should be documented in writing to facilitate compliance with internal controls, including proper authorisation of actions taken by or on behalf of the supervisor. In addition, well-defined communication channels help ensure prompt escalation of significant issues to appropriate levels within the supervisor.

2.4.3 The supervisor should have a process to develop and implement a strategic plan that sets out its goals and priorities, given the responsibilities and objectives assigned to it by legislation. Such a plan should cover a specific period of time, such as two or three years. The supervisor should report on its performance against that plan to the government and other stakeholders, including insurance industry participants, consumers and the general public.

2.4.4 The supervisor should identify the individual or group of individuals responsible for the implementation and review of the internal governance arrangements. The internal governance processes and procedures should be subject to regular independent review, for example by an internal audit function or a public auditor.

2.5 The supervisor applies requirements and supervisory procedures consistently and equitably.

2.5.1 The supervisor should have internal mechanisms to help ensure that it is consistent in the actions and decisions it takes.

2.5.2 Cases where circumstances are similar should lead the supervisor to take similar actions or decisions. Actions taken in a particular case in the past should be considered in new cases where the circumstances are similar, unless a change in the requirements or supervisory procedures occurred in the time between the two cases.

2.6 There are processes to appeal against supervisory decisions which do not unduly impede the ability of the supervisor to make timely interventions in order to protect policyholders' interests or contribute to financial stability.

2.6.1 Procedural fairness enhances public confidence in the supervisory process. Parties subject to a decision made by the supervisor should be able to receive the written reasons for the decision and to appeal the

decision to an impartial review body or tribunal. The manner in which the supervisor's decision could be subject to judicial review, or in which decisions can be appealed, should be defined and transparent, and included in the notification of the decision.

2.6.2 The existence of an appeal or review mechanism helps ensure that the supervisor's decisions are made within the law as consistently as possible and are well reasoned. Appeal processes should be specific and balanced to preserve supervisory independence and effectiveness. However, these processes should allow the supervisor to exercise its powers quickly in cases where expeditious action is required. In certain cases, these processes may provide that the decision of the supervisor remains in force until the appeal or review mechanism has produced a final decision on the appeal, unless otherwise ordered by a court.

2.7 The supervisor, including its staff and any third party acting on its behalf (presently or in the past), are required by legislation to protect confidential information in the possession of the supervisor.

2.7.1 The type of information that the supervisor is required to keep confidential should be specified in legislation. Generally, any non-public information received relating to a supervised entity would be considered confidential, as well as information received from another supervisor (see ICP 3 Information Sharing and Confidentiality Requirements). Legislation should also specify the circumstances under which the supervisor is allowed to disclose confidential information and to whom it can be disclosed.

2.7.2 The supervisor should protect confidential information. Safeguards should apply to information maintained in any format, including in physical form as well as electronic. The supervisor should assess the sensitivity of various categories of information in its possession, and identify the appropriate data protection requirements applicable to each category, including the duration of the retention period for information in each category.

2.7.3 The supervisor and its staff, including former staff, and all persons acting on its behalf (presently or in the past) should be liable to penalties for unlawful access to, use of, or disclosure of, confidential information. This includes any outside experts hired by the supervisor and persons to which the supervisor outsourced any supervisory function. The penalties for such conduct should be specified in legislation and may include disciplinary actions, up to and including termination of employment, and criminal or legal proceedings. The duty of confidentiality should survive the termination of employment of a staff member or other third party engaged by the supervisor.

Transparency

2.8 The supervisor is transparent to the public, supervised entities and the government about how it exercises its responsibilities.

2.8.1 Transparency reinforces accountability of supervisors. The supervisor should publish information about itself and the insurance sector, including:

- its objectives and responsibilities;
- its goals and priorities for the future;
- its activities in light of its goals and priorities in the previous year;
- its resources, including human, technological and financial;
- data and analysis about the state of the insurance sector; and
- supervisory measures taken in relation to problem or failed insurers, subject to confidentiality considerations and in so far as it does not jeopardise other supervisory objectives or prejudice another case pending before the supervisor.

2.8.2 The supervisor should seek to publish a report at least annually that contains the elements listed above as well as its audited financial statements. This type of report is a key document by which a supervisor accounts to its stakeholders.

2.9 The supervisor publishes its requirements, policies and supervisory procedures. The supervisor consults publicly on significant changes that it makes to requirements, policies and supervisory procedures.

2.9.1 The supervisor publishes and regularly reviews requirements, policies and supervisory procedures to ensure they remain appropriate for the characteristics of the industry, emerging risks and evolving international standards. Some requirements may be contained in primary legislation, while others may be contained in instruments issued by the supervisor, such as guidance and industry advice. The supervisor should ensure these instruments are made available to the public, for example on the supervisor's website.

2.9.2 A critical element of transparency is for the supervisor to provide the opportunity for meaningful public consultation on proposed requirements and supervisory procedures. Meaningful public consultation benefits from participation by a diversity of stakeholders. Consequently, the supervisor should have methods in place to encourage and solicit stakeholder participation.

2.9.3 The supervisor should have written procedures on the types of documents that are subject to public consultation as well as the process and timelines for consultation. Some documents used in the supervisory process may not be suitable for consultation, such as detailed procedural manuals that are used to guide staff of the supervisor in the performance of their day-to-day duties.

2.9.4 In some jurisdictions, the development and issuance of requirements may be outside of the control of the supervisor; for example, the power to enact legislation may be vested in another government body or supranational bodies that have a direct role in the legislation in force in their member countries. In such cases, the consultation process may also be outside the remit of the supervisor. To the extent possible, the supervisor should be involved in the development of the requirements, for example, by participating in consultations, and the supervisor should keep the public and the industry informed of proposed changes.

Resources

2.10 The supervisor has sufficient resources, including human, technological and financial resources, to enable it to conduct effective supervision.

2.10.1 The supervisor's financial resources and staffing policies should enable it to attract and retain highly skilled, competent and experienced staff with the necessary professional qualifications, where required. The supervisor should have the ability to hire or contract the services of external experts when necessary.

2.10.2 The supervisor should have a process for regularly reviewing its human resources needs, the skills and experience of existing staff and its projected human resource requirements over the short to medium term.

2.10.3 This review could lead the supervisor to implement initiatives to bridge gaps in numbers and/or skills. These could include more flexible hiring policies or schemes for secondment of staff from industry or other supervisory authorities within the jurisdiction or internationally. These initiatives may help in providing access to specialist skills on a temporary basis. Secondments for supervisory staff to industry or other supervisory authorities enhance the skills and experience of staff particularly to better understand industry practices. When implementing such initiatives, the supervisor should have safeguards in place to avoid conflicts of interest and protect confidential information, such as by restricting access to certain information.

2.10.4 The supervisor should provide adequate training opportunities for its staff to ensure that their skills and supervisory practices remain up to date with evolving supervisory and regulatory developments and changes in the industry.

2.10.5 The technological resources available to the supervisor should enable supervisory staff to collect and store securely, quickly access, and efficiently analyse information about the entities it supervises.

2.11 Where the supervisor outsources supervisory activities to third parties, the supervisor:

- **sets expectations for their role and work;**
- **monitors their performance;**
- **ensures their independence from the supervised entity or any other related party; and**
- **subjects them to the same confidentiality rules and professional standards as the staff of the supervisor.**

2.11.1 Outsourcing of selected supervisory activities to third parties can complement the supervisor's resources with valuable expertise. However, supervisory activities are primarily the responsibility of the supervisor. The supervisor should retain accountability for and oversight of any outsourced activities to the same degree as non-outsourced activities. Outsourcing should not adversely affect the supervisor`s ability to conduct effective supervision or meet its objectives.

2.11.2 The process used to select third party providers should be fair, open and transparent. All qualified third party providers should have equal access

to information regarding the process. Prior to engaging a third party, the supervisor should assess the proposed provider's competence and experience and the safeguards for the handling of data, including treatment of confidential information. The decision to select a provider should be made free from conflicts of interest, or where such conflicts cannot be avoided, they should be managed.

2.11.3 A written agreement should govern the relationship between the supervisor and the third party provider. The agreement should describe all material aspects of the outsourcing arrangement, including the services to be provided, remuneration of the third party provider, resolution of disputes and procedures governing the sub-contracting of services.

ICP 3 Information Sharing and Confidentiality Requirements

The supervisor obtains information from, and shares information with, relevant supervisors and authorities subject to confidentiality, purpose and use requirements.

3.1 The supervisor requests information, including non-public information, from relevant supervisors and authorities with respect to insurers.

3.1.1 Information requested by a supervisor from a relevant supervisor or authority may include:

- information on strategy, business activities and business models including prospective and recent acquisitions or disposals of insurance business;
- financial data relating to an insurer;
- organisational structure, both legal and management structure;
- information on the management and operational systems and controls used by insurers;
- information on individuals holding positions of responsibility in insurers such as Board Members, Senior Management, Key Persons in Control Functions and Significant Owners;
- information on individuals or insurers involved, or suspected of being involved, in criminal activities;
- information on any failures to comply with supervisory requirements, regulatory investigations and reviews, and on any restrictions imposed on the business activities of insurers;
- information concerning regulated entities related to the insurance group, whether undertaking insurance business or other financial business which is subject to regulation, and information concerning non-regulated entities related to the insurance group such as service companies or holding companies;
- specific information requested and gathered from a regulated entity; and
- reporting information within groups to meet group supervisory requirements, including subsidiaries and non-regulated holding companies.

3.1.2 Relevant supervisors and authorities, whether in the same or a different jurisdiction, may include:

- other insurance supervisors;
- supervisors responsible for banks and other credit institutions;
- supervisors responsible for investments, securities, pensions, financial markets and other sectors;

- authorities responsible for the recovery or resolution of insurers;
- authorities responsible for anti-money laundering or combating the financing of terrorism; and
- law enforcement agencies.

3.2 The supervisor shares information, including non-public information, with relevant supervisors and authorities at its sole discretion and subject to appropriate safeguards.

Agreements on information sharing

3.2.1 Supervisors and authorities are responsible for ensuring the safe handling of confidential information. Although the existence of an agreement or understanding on providing requested information may not be a prerequisite for sharing information, the supervisor is encouraged to use agreements, including memoranda of understanding (MoUs), to facilitate information sharing between relevant supervisors and authorities. Such agreements are important to information sharing among supervisors and authorities to establish a framework to facilitate the efficient exchange of confidential information and document the types of information that may be shared as well as the terms and conditions under which the information can be shared and passed on to other relevant supervisors and authorities. Such agreements may be distinguishable from coordination agreements used in supervisory colleges (see ICP 25 Supervisory Cooperation and Coordination).

3.2.2 The supervisor should use bilateral or multilateral agreements to facilitate information sharing because they provide the basis for a two-way flow of information and the basis for confidential treatment of the information shared. The IAIS MMoU is an example of a multilateral memorandum of understanding for cooperation and exchange of information between supervisors related to the supervision of insurance legal entities and insurance groups. All signatories to the IAIS MMoU undergo a validation of their laws and regulations to demonstrate compliance with the MMoU's strict confidentiality regime. For this reason, if all relevant parties are signatories to the IAIS MMoU, it is the preferred framework for multilateral information exchange.

Information Sharing in Supervisory Colleges

3.2.3 Supervisory colleges can provide a framework for supervisory cooperation and crisis management in which information sharing between involved supervisors occurs on an ongoing basis.

3.2.4 Information sharing 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 among supervisors, particularly in relation to exchange and protection of confidential information.

3.2.5 Each member of the college should take measures necessary to avoid the unintentional divulgence of information or the unauthorised release of confidential information. It is important that appropriate information exchange agreements or other arrangements are in place between the

members of the supervisory college to ensure that information can be exchanged in a secure environment.

3.2.6 Where confidential information exchanged within a supervisory college is communicated to relevant supervisors or authorities who are not involved in the college, supervisors should:

- have a formal mechanism in place between the group-wide supervisor and the other supervisors or authorities to ensure the protection of the confidential information. Such mechanisms could be included in the relevant information sharing agreements; and
- obtain the prior consent of the supervisor having provided such information.

3.3 The supervisor requesting confidential information (the requesting supervisor) has a legitimate interest and valid supervisory purpose related to the fulfilment of its supervisory functions in seeking information from another relevant supervisor or authority.

3.3.1 A legitimate interest is derived from the powers and responsibilities the requesting supervisor has in relation to the subject matter of the request. For example:

- if the requesting supervisor only has the power and responsibility to supervise intermediaries and not insurers, it may not have a legitimate interest in requesting information relating to an insurer; or
- if the requesting supervisor requests information relating to an insurer that has no current or planned operations or other connections to the requesting supervisor's jurisdiction, it may not have a legitimate interest in requesting such information.

3.3.2 A valid supervisory purpose is relevant to the requesting authority's performance of a supervisory task. Valid supervisory purposes may include information requested for the purposes of:

- licensing;
- suitability criteria;
- intra-group transactions such as loans and extensions of credit, parental guarantees, management agreements, service contracts, cost-sharing arrangements, reinsurance agreements, dividends and distributions;
- prevention of financial crime, such as fraud, anti-money laundering or combating the financing of terrorism;
- ongoing supervision, including preventive and corrective measures and sanctions; and
- exit from the market and resolution.

3.3.3 A supervisor may voluntarily provide information to other relevant supervisors so as to better enable the supervisors' fulfilment of their supervisory functions. In such cases, the supervisor providing

information should adhere to the same requirements as though the information had been requested by a requesting supervisor.

3.4 The supervisor that has received a request for confidential information (the requested supervisor) from another relevant supervisor or authority:

- **assesses each request for information on a case-by-case basis; and**
- **responds to requests in a timely and comprehensive manner.**

3.4.1 In principle, the requested supervisor is expected to share information with a requesting supervisor with a legitimate interest and for a valid supervisory purpose.

3.4.2 In deciding whether and to what extent to fulfil a request for information, the requested supervisor may take into account matters including:

- the nature of the information to be provided;
- the purpose for which the information will be used;
- the ability of the requesting supervisor or authority to maintain the confidentiality of any information received, taking account of the IAIS MMoU or other existing agreements in each jurisdiction;
- whether, in the context of supervisory college or otherwise, the request is covered by a coordination agreement;
- whether it would be contrary to the interest of the jurisdiction of the requested supervisor; and
- relevant laws and regulations in each jurisdiction (in particular those relating to confidentiality and professional secrecy, data protection and privacy, and procedural fairness).

3.4.3 While requests for information should normally be made in writing, the requested supervisor should not insist on written requests in an emergency situation, and should not unreasonably delay a response to an oral request for information made for a valid supervisory purpose by a requesting supervisor.

3.4.4 The requested supervisor may receive a request for information which is not already in their possession. In such circumstances, the requested supervisor should, if it considers it reasonable, obtain that information from the insurer or other entities from which it has the power to obtain information.

3.4.5 If the requested supervisor denies a request, it should explain its reason for the denial to the requesting supervisor or authority.

3.4.6 Lack of strict reciprocity should not be used by the requested supervisor as the reason for not sharing information that would otherwise be appropriate to share, particularly in an emergency or other crisis situation. Strict reciprocity in terms of the level, format and detailed characteristics of information requested is not required.

3.5 The requesting supervisor uses confidential information received from the requested supervisor or authority only for the purposes specified when the

information was requested. Unless otherwise agreed, before using the information for another purpose or passing it on to others, the requesting supervisor obtains agreement of the requested supervisor or authority.

3.5.1 The requesting supervisor should specify the intended purposes of the information sought. Additionally, MoUs may address purposes for which the requested information may be used by the requesting supervisor.

3.5.2 The requesting supervisor first obtains agreement with the requested supervisor or authority before passing on requested information. Supervisors and authorities are encouraged to request information directly from the requested supervisor, rather than from the requesting supervisor, to provide an opportunity for direct dialogue and further consultation. Requesting supervisors should ensure that appropriate confidentiality requirements are in place and the information is only passed on to another relevant supervisor or authority with a legitimate interest and – in case of a supervisory authority – for valid supervisory purposes.

3.5.3 There are specified circumstances within the IAIS MMoU where signatories are expected to consent to the passing on of information to other relevant supervisors and authorities. This includes situations where passing on information will assist:

- other IAIS MMoU signatories in the fulfilment of their supervisory functions; and
- other relevant domestic financial sector bodies such as central banks, law enforcement agencies, relevant courts and other authorities (see Annex B of the IAIS MMoU).

3.5.4 Conditions imposed by the requested supervisor on the passing on of information to third parties should not prevent the requesting supervisor or authority from being able to use the information for its own valid supervisory purposes.

3.6 In the event the requesting supervisor has received notice of proceedings, which may legally compel it to disclose confidential information which it has received from the requested supervisor, the requesting supervisor:

- **to the extent permitted by law, promptly notifies the requested supervisor; and**
- **where consent to disclosure is not given, uses all reasonable means to resist the demand and to protect the confidentiality of the information.**

3.6.1 Where allowed by the laws and practices of the jurisdiction, a requesting supervisor required to disclose confidential information by legal compulsion should place, or seek to place, protections from disclosure on that information. Such protections could include:

- a protective order placing restrictions on use or further distribution of the confidential information; or
- limitations on the means and location of the disclosure of the confidential information.

ICP 4 Licensing

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 (eg 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;
- activities are pursued following the idea of solidarity between policyholders (eg, 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 (eg 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. The applicant is required at least 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 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 processes.

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.

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 a legal 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 legal 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 (eg 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 ongoing supervision of the insurance

legal entity (see ICP 9 (Supervisory Review and Reporting) and ICP 10 (Preventive Measures, Corrective Measures and Sanctions).

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 (eg 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 supervises 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 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

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. The legislation includes at least Board Members, Senior Management, Key Persons in Control Functions and Significant Owners.

5.1.1 Suitability requirements may extend to other individuals (eg 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. More extensive efforts should be made to train those with more limited financial, regulatory or risk-related experience.

CF 5.2.a **The group-wide supervisor requires the IAIG Board Members (individually and collectively), Senior Management, and Key Persons in Control Functions, to have the necessary competence to fulfil their role, taking into account the complexity and international nature of the IAIG, any specific features of the jurisdictions where the IAIG operates, and the risks to which it is exposed.**

CF 5.2.a.1 Appropriate competencies include, for example, knowledge of and experience with international business and processes, as well as with different business models.

Suitability requirements for Significant Owners

5.2.5 The necessary qualities of a Significant Owner relate at least 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, eg 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 a legal 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 a legal 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 (eg, 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, 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 (see ICP 3 Information Sharing 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

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 such as those 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 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 Sharing 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. A significant owner should possess at least 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 portfolio 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

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; ie 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.

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.

CF 7.0.a **The group-wide supervisor requires the Head of the IAIG to document the legal and management structures of, and inter-relationships within, the IAIG to enable an understanding of its structure to help identify risks and how they are managed.**

CF 7.0.a.1 The documentation should mainly support the IAIG Board and Senior Management in discharging their responsibilities, but can also be useful for the group-wide supervisor.

CF 7.0.a.2 The documentation covers legal entities within the IAIG and, where relevant, the wider group of which the IAIG is part, and includes items such as:

- home jurisdiction of the Head of the IAIG;
- the jurisdictions of legal entities within the IAIG, including branches;
- off-balance sheet entities;
- materiality of legal entities or business lines within the IAIG;
- financial ties (such as commercial contracts) and non-financial ties (such as common directors);
- details of the shareholding structure and significant shareholdings, including controlling shareholders;
- governance structure, including Boards and their committee structure and key responsibilities; and
- management structure, including the division of authority and decision making between business line management, local management, and Board oversight.

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 (ie, 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, and clear reporting lines between the head of the group and the legal entities within the group.

7.0.8 When setting up or monitoring their corporate governance framework, insurance groups should evaluate the specific challenges which may arise from the organisational model adopted by a group (e.g. more centralised or more 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 (see Issues Paper on Approaches to Group Corporate Governance; Impact on Control Functions).

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.

CF 7.0.b	**The group-wide supervisor requires the Head of the IAIG to ensure that the group-wide corporate governance framework is appropriate to the structure, business and risks of the IAIG including its legal entities.**
CF 7.0.c	**The group-wide supervisor requires the Head of the IAIG to establish clear reporting lines between the legal entities within the IAIG and the Head of the IAIG.**

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 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. Where individuals undertake functions for more than one legal entity within a group, the group should have in place appropriate measures so that conflicts of interest between the different roles to be performed by such individuals are avoided, or where such conflicts cannot be avoided, they should be managed.

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

- ensure that there are adequate policies and processes 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 processes, 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 purpose and such reports may include internal or external independent reports as appropriate.

CF 7.1.a **The group-wide supervisor requires the IAIG Board to establish a well-defined group-wide governance structure, which promotes effective oversight of the group-wide operations independent of day-to-day management.**

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 (eg 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 (eg 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.

CF 7.2.a **The group-wide supervisor requires the IAIG Board to ensure that the group-wide business objectives, and strategies for achieving those objectives, take into account at least the following:**

- **applicable laws and regulations of, and the risks which may arise from doing business in, the jurisdictions in which the IAIG operates;**
- **long term financial safety and soundness of the IAIG;**
- **the interests of policyholders and other stakeholders;**
- **fair treatment of customers; and**
- **the interests and objectives of the insurance legal entities within the IAIG.**

CF 7.2.a.1 The IAIG Board should establish processes for identifying and addressing risks to the proper implementation of the IAIG's objectives and strategies for achieving those objectives, including any emerging risks.

CF 7.2.a.2 The group-wide supervisor should cooperate and coordinate with the other involved supervisors to compare the consistency of the interests and objectives of the IAIG with those of the insurance legal entities within the IAIG.

CF 7.2.b **The group-wide supervisor requires the Head of the IAIG to provide to the group-wide supervisor, at least annually, an explanation of the strategy that the IAIG Board has set for the IAIG.**

CF 7.2.b.1 An explanation of the strategy provides the group-wide supervisor with information useful for understanding of the IAIG's corporate governance framework. The explanation of the strategy should include matters such as:

- the overall business model and its rationale;
- material business lines and how they are likely to develop;
- non-insurance business activities the IAIG is likely to pursue;
- the geographic emphasis of the IAIG and any likely changes;
- anticipated changes in market share(s);
- the consequences (financial or otherwise) of achieving, or not achieving, the strategy; and
- how the strategy ensures the IAIG will have the ability to fulfil its obligations to policyholders.

Structure and governance of the Board

7.3 The supervisor requires the insurer's Board to have, on an ongoing 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.

CF 7.3.a The group-wide supervisor requires that the collective competence of the IAIG Board includes an understanding of at least:

- **the group-wide corporate governance framework and corporate structure;**
- **the activities of the legal entities within the IAIG, including associated risks;**
- **the supervisory regimes applicable to the IAIG;**
- **the issues that arise from cross-border business and international transactions; and**
- **the risk management, compliance, audit, actuarial and related areas.**

CF 7.3.a.1 The IAIG Board should be capable of understanding and describing the purpose, structure, strategy, material operations, and material risks of the IAIG, including those of legal entities in other financial sectors and unregulated legal entities that are part of the group.

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 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 (ie 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.

CF 7.3.b The group-wide supervisor requires the IAIG Board to ensure that the group-wide corporate governance framework includes policies and processes to identify and avoid, or manage, conflicts of interest that may adversely affect the IAIG as a whole or any of its legal entities.

CF 7.3.b.1 Conflicts of interest within an IAIG could arise:

- at the level of the Board, Senior Management and Key Persons in Control Functions of the Head of the IAIG and of its legal entities; and
- among the interests of the legal entities, or between the group-wide interests and those of any legal entity. For example, when the IAIG may be harmed by actions of insurance legal entities within the IAIG, or when an insurance legal entity within the IAIG may be harmed by the actions of the IAIG.

CF 7.3.b.2 Where conflicts of interest involving individuals or legal entities cannot be avoided, the relevant individuals or legal entities should inform the relevant Board or the IAIG Board of the conflict and take measures to mitigate its adverse impact.

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 least, 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 least, 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 framework 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 managed. 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 (eg 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 (ie 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 condition and viability.

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 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 (eg 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 framework 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.

CF 7.9.a **The group-wide supervisor requires the IAIG Board to ensure that the Head of the IAIG reports to the group-wide supervisor, through regularly scheduled or ad hoc reporting, material changes related to at least the following:**

- **location of legal entities;**
- **legal structures;**
- **management structures;**
- **governance structure and processes of the IAIG Board;**
- **affiliations with other groups;**
- **strategy;**
- **risk appetite; and**
- **business activities.**

CF 7.9.a.1 The group-wide systems and controls for communications should give the Head of the IAIG the ability to inform the group-wide supervisor of governance issues concerning the IAIG.

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.

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

7.9.7 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 processes.

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, ongoing 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 ongoing 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 ongoing 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 ongoing effectiveness of the Board and Senior Management, the supervisor may also consider the use of measures such as the following, where appropriate:

- ongoing 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 ongoing viability of the insurer or commissioning an independent assessment of the insurer's remuneration policy and practices.

ICP 8 Risk Management and Internal Controls

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.

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, ie, a more centralised or a more decentralised approach (see Issues Paper on Approaches to Group Corporate Governance; impact on control functions). 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 and documented risk management system, which includes, at least:

- **a risk management strategy that defines the insurer's risk appetite;**
- **a risk management policy outlining how all material risks are managed within the risk appetite; and**
- **the ability to respond to changes in the insurer's risk profile in a timely manner.**

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 should:

- take into account the insurer's overall business strategy and business activities (including any business activities which have been outsourced);
- provide that the insurer's risk appetite, expressed in a risk appetite statement, be aligned with the insurer's business strategy and embedded in its day-to-day activities;
- provide relevant objectives, key principles and proper allocation of responsibilities for dealing with risk across the business areas and business units of the insurer;
- provide explanations of the methodologies, key assumptions and limitations of risk management; for groups this would include the rationale as to the risk appetite for different individual insurance legal entities within the group;
- provide 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;
- define and categorise material risks (by type) to which the insurer is exposed, at both insurance legal entity and group level where applicable, and the levels of acceptable risk limits for each type of these risk;
- include documented policies that describe how categories of risks are managed and the specific obligations of employees and the insurer in dealing with risk, including risk escalation and risk mitigation tools;
- provide 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;
- provide for 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; and
- appropriately address other matters related to risk management for solvency purposes set out in ICP 16 Enterprise Risk Management for Solvency Purposes.

Scope and embedding of the risk management system

8.1.3 The risk management system should cover at least the following risks: underwriting and reserving, asset-liability management, investments, liquidity, concentration, operational and conduct, as well as 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.

CF 8.1.a **The group-wide supervisor requires the Head of the IAIG to ensure that the group-wide risk management system encompasses the levels of the Head of the IAIG and legal entities within the IAIG and covers, at least, the:**

- **diversity and geographical reach of the activities of the IAIG;**
- **nature and degree of risks of individual legal entities and business lines;**
- **aggregation of risks from the legal entities within the IAIG that arises at the level of the Head of the IAIG, including cross-border risks;**
- **interconnectedness of the legal entities within the IAIG;**
- **level of sophistication and functionality of information and reporting systems in addressing key group-wide risks; and**
- **applicable laws and regulations of the jurisdictions where the IAIG operates.**

CF 8.1.a.1 The group-wide risk management system should:

- be integrated with its organisational structure, decision-making processes, business operations, and risk culture;
- be integrated within its legal entities; and
- measure the risk exposure of the IAIG against the risk limits on an ongoing basis in order to identify potential concerns as early as possible.

CF 8.1.b **The group-wide supervisor requires the Head of the IAIG to reflect, in the documentation of its group-wide risk management system, material differences in risk management that may apply to different legal entities within the IAIG and their associated risks.**

CF 8.1.c **The group-wide supervisor requires the Head of the IAIG to ensure that the IAIG has in place policies and processes for promoting a sound risk culture.**

CF 8.1.c.1 Policies and processes for promoting a sound risk culture should include risk management training, address independence, and create appropriate incentives for staff.

CF 8.1.c.2 The IAIG's risk culture should support timely evaluation and open communication of emerging risks that may be significant to the IAIG and its legal entities.

Identification and Assessment

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 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.

8.1.7 The insurer's risk assessment should be documented including detailed descriptions and explanations of the risks covered, the approaches used, and the key judgements and assumptions made.

8.1.8 Insurers should have in place adequate processes, controls and systems to assess the risks of new products and carry out a risk assessment before entering into new business lines and products. Significant new or changed activities and products that may increase an existing risk or create a new type of exposure should be approved by Senior Management and/or by the Board.

Monitoring

8.1.9 The risk management system should include processes and tools for monitoring risk, such as early warnings or triggers that allow timely consideration of, and adequate response to, material risks.

Mitigation

8.1.10 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

8.1.11 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.

8.1.12 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 Management Policy

8.1.13 The insurer's risk management policy should be written in a way to help employees understand their responsibilities regarding risk management. It should also reflect how the risk management system relates to the insurer's overall corporate governance framework and its corporate culture. Regular internal communications and training within the insurer on the risk management policy and risk appetite may help in this regard.

8.1.14 For insurance groups, a risk management policy addresses the way in which the group manages risks that are material at the insurance group level, including risks that arise from the insurance group being part of a

wider group. For an insurance legal entity that is part of a group, the risk management policy of that entity should address management of risks material at the entity level as well as additional risk it faces as a result of its membership in a group, which can encompass the widest group of which the insurance legal entity is a member and not only the entity's insurance group. Within an insurance group, the head of the group and the legal entities should ensure appropriate coordination and consistency between the head of the group and the legal entities when setting the risk management policy.

Changes to the risk management system

8.1.15 Both the Board and Senior Management should be attentive to the need to modify the risk management system in light of changes in the insurer's risk profile as well as other new internal or external events and/or circumstances. The risk management system should include mechanisms to incorporate new risks and new information related to risk already identified on a regular basis. The risk management system should also be responsive to the changing interests and reasonable expectations of policyholders and other stakeholders.

8.1.16 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.

8.1.17 As part of its responsiveness to changes in the insurer's risk profile, the risk management system should incorporate a feedback loop based on appropriate information, management processes and objective assessment. A feedback loop provides a process of assessing the effect of changes in risk leading to changes in risk management policy, risk limits and risk mitigating actions. This may help 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.

8.1.18 Within an insurance group, there should be sufficient coordination and exchange of information between the head of the insurance group and its insurance legal entities as part of their respective feedback loops to ensure relevant changes in risk profiles can be taken into account.

CF 8.1.d The group-wide supervisor requires the Head of the IAIG to:

- **review, at least annually, the group-wide risk management system to ensure that existing and emerging risks as well as changes in the IAIG's structure and/or business strategy, are taken into account; and**
- **identify and make the necessary modifications and improvements in a timely manner.**

CF 8.1.d.1 The Head of the IAIG should assess whether a change occurring in one or more legal entities may affect the IAIG's risk profile overall,

	because the impact on a group-wide basis may not be immediately apparent.
CF 8.1.d.2	The group-wide risk management system should take account of all material changes at a legal entity level that may have an impact on how the IAIG measures and mitigates risk at a group level.

8.2 The supervisor requires the insurer to establish, and operate within, an effective and documented 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[1] 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 processes. 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.[2]

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

[1] 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.

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

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;
- 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 framework 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.

CF 8.2.a **The group-wide supervisor requires the Head of the IAIG to ensure that the group-wide internal controls system at the group-wide level covers, at least, the:**

- **diversity and geographical reach of the activities of the IAIG;**
- **intra-group transactions;**
- **interconnectedness of the legal entities within the IAIG; and**
- **applicable laws and regulations of the jurisdictions where the IAIG operates.**

CF 8.2.b **The group-wide supervisor requires the Head of the IAIG to ensure annual testing and assessments carried out by an independent external or internal party to assess the coherence, completeness and effectiveness of the internal controls system within the IAIG and its utility to the IAIG Board and Senior Management.**

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.

CF 8.3.a The group-wide supervisor requires the Head of the IAIG to ensure that:

- **the tasks and responsibilities of the group-wide control functions, whether located at the level of the Head of the IAIG or within another legal entity of the IAIG, are clearly defined; and**
- **these group-wide control functions do not duplicate, limit or restrict the tasks and responsibilities of control functions at the insurance legal entity level.**

CF 8.3.b The group-wide supervisor requires the Head of the IAIG to ensure that the group-wide control functions:

- **coordinate with the control functions at the insurance legal entity level; and**
- **ensure effective group-wide management reporting.**

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, eg 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 organised 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 (eg 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.

CF 8.3.c **The group-wide supervisor requires the IAIG Board to ensure that the group-wide control functions:**

- **are not combined, unless exceptional circumstances apply;**
- **are subject to periodic review either by the group-wide internal audit function (for control functions other than internal audit) or an independent external party;**
- **have unrestricted access and periodically report to the IAIG Board or one of its committees; and**
- **have access to people and information, on a group-wide or legal entity level, to carry out their responsibilities.**

CF 8.3.c.1 The group-wide supervisor should assess on a case-by-case basis whether the exceptional circumstances justify a combination of group-wide control functions on a time-limited basis.

CF 8.3.c.2 When assessing whether to allow for a combination of group-wide control functions, the group-wide supervisor should consider at least whether:

- the combination would give rise to potential conflicts of interest and how they could be resolved – either for affected individuals and/or the combined group-wide control functions (for example, where one group-wide control function has responsibilities for reviewing another);
- the individuals in charge of combined group-wide control functions would have the necessary availability or resources to perform efficiently the tasks related to both functions; and
- the combined group-wide control functions would undermine the ability of either function to fulfil its responsibilities in assisting the IAIG Board and Senior Management in maintaining adequate oversight across the IAIG. This risk is likely to be greater where control functions across different lines of defence are combined.

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 ongoing 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.

CF 8.4.a **The group-wide supervisor requires the Head of the IAIG to ensure that the group-wide risk management function, at least:**

- **coordinates and monitors consistent and effective implementation of risk management mechanisms and activities at the group-wide level and at the legal entity level;**
- **sets out expectations relating to the group-wide responsibilities and reporting of the risk management function of each legal entity within the IAIG, as applicable;**
- **sets policies and processes for effective interaction between the risk management functions of the Head of the IAIG and of the legal entities within the IAIG;**
- **assesses the group-wide risk management strategy, which is approved by the IAIG Board, and ensures that this risk management strategy, including supporting processes, is implemented at the group-wide level;**
- **annually plans and conducts an assessment of risks at the group-wide level, including those that arise from the legal entity and material business line level; and**
- **provides at least quarterly risk management reports to the IAIG Board or one of its committees.**

CF 8.4.b **The group-wide supervisor requires the group-wide risk management function to be independent from risk taking activities.**

Compliance function

8.5 **The supervisor requires the insurer to have an effective compliance function capable of assisting the insurer to i) meet its legal, regulatory and supervisory obligations and ii) 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, 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 (eg 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.

CF 8.5.a **The group-wide supervisor requires the Head of the IAIG to ensure that the group-wide compliance function at least:**

- **coordinates and monitors consistent and effective implementation of compliance mechanisms and activities at the group-wide level and at the legal entity level;**
- **sets appropriate policies and processes regarding the legal and regulatory obligations of the IAIG and its legal entities;**
- **assesses the material legal and regulatory obligations and compliance risks of the IAIG, and the steps being taken to fulfil or address them, at least annually and as required by the Board;**
- **supports the IAIG Board in fostering an effective corporate culture throughout the IAIG;**
- **assesses how the IAIG itself is, and the legal entities within the IAIG are, performing against group-wide compliance standards and goals; and**
- **provides at least quarterly written reports on its activities to the IAIG's Board or one of its committees.**

Actuarial function

8.6 **The supervisor requires the insurer to have an effective actuarial function capable of evaluating and providing advice regarding, at least, 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 regard 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.

CF 8.6.a **The group-wide supervisor requires the Head of the IAIG to ensure that the group-wide actuarial function performs an overview of the group-wide actuarial activities, functions and risks emanating from insurance legal entities within the IAIG. This overview includes, at least:**

- **risk assessment and management policies and controls relevant to govern the activities of the group-wide actuarial function or financial condition;**
- **actuarial concerns related to any insurance legal entity within the IAIG, or the IAIG as a whole, as applicable;**
- **the IAIG's solvency position, based on calculations of group-wide regulatory capital requirements and technical provisions;**
- **the IAIG's prospective solvency position, based on capital adequacy assessments and stress tests, under various scenarios, and their relative impact on assets, liabilities, and actual and future capital levels;**
- **the adequacy of the IAIG's reinsurance arrangements; and**
- **actuarial-related risk modelling in the IAIG's Own Risk and Solvency Assessment (ORSA) and use of internal models.**

CF 8.6.b **The group-wide supervisor requires the Head of the IAIG to ensure that the group-wide actuarial function:**

- **works with the actuarial functions at the insurance legal entity level to review actuarial information; and**
- **provides independent advice and at least annually reports to the IAIG Board or one of its committees on the insurance activities and risks posed to the IAIG.**

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 and supervisory requirements 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.

CF 8.7.a **The group-wide supervisor requires the IAIG Board to ensure that the group-wide internal audit function provides independent assessment and assurance to the IAIG Board regarding, at least, the:**

- **group-wide policies, processes, and controls;**
- **overall means by which the IAIG preserves its assets, and those of policyholders, and seeks to prevent fraud, misappropriation or misapplication of such assets;**
- **reliability, integrity and completeness of the accounting, financial, management, information technology systems and risk reporting information;**
- **capacity and adaptability of information technology systems to provide information in an accurate and timely manner to the IAIG Board and Senior Management; and**
- **design and operational effectiveness of the group-wide risk management and internal controls systems, both individually and overall.**

CF 8.7.a.1 The group-wide internal audit function coordinates with the internal audit functions and external auditors of the legal entities within the IAIG when providing assessment and assurance to the IAIG Board.

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 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.

CF 8.8.a The group-wide supervisor requires the Head of the IAIG to have:

- **a policy which takes into account the potential impact on the IAIG of outsourcing of any material group-wide activity or function, sets out the internal review and approvals required, and provides guidance on the contractual and other risk issues to consider; and**
- **written contracts that describe all material aspects of the outsourcing arrangement, including the rights, responsibilities and expectations of all parties.**

CF 8.8.b When choosing a service provider (either internal or external) for a material group-wide activity or function that is to be outsourced, the group-wide supervisor requires the Head of the IAIG to:

- **assess the potential service provider's ability and capacity to deliver the outsourced activities or functions;**
- **perform due diligence on the service provider with respect to explicit or potential conflicts of interest that would jeopardise the fulfilment of the needs of the IAIG; and**
- **ensure that the service provider has the necessary resources to perform the outsourced activities or functions in a proper and reliable way, as well as adequate contingency plans in**

place to deal with emergency situations or business disruptions.

CF 8.8.b.1 Activities or functions may be outsourced to an internal service provider (ie a legal entity which is part of the IAIG) or an external service provider. In the case of an internal service provider, the assessment and due diligence process may be different from the case of an external service provider. For example, if the internal service provider has already been assessed recently, some aspects of the assessment may not need to be repeated. Even though the assessment process used may vary between an internal or external service provider, it should be equally robust.

CF 8.8.c **The group-wide supervisor requires the Head of the IAIG to ensure that outsourcing (either internal or external) of a group-wide activity or function does not impede effective supervision of the Head of the IAIG.**

CF 8.8.d **The group-wide supervisor requires the Head of the IAIG to carry out a periodic review of the cumulative risks of outsourced activities and functions and address identified risks.**

ICP 9 Supervisory Review and Reporting

The supervisor uses off-site monitoring and on-site inspections to: examine the business of each insurer; evaluate its financial condition, conduct of business, corporate governance framework and overall risk profile; and assess 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 ICP focuses on the general processes and procedures supervisors should have in place with respect to supervisory review and reporting. For the purpose of this ICP, off-site monitoring and on-site inspections are collectively referred to as "supervisory review". Aspects of what supervisors may require or assess as part of supervisory review and reporting on specific areas (such as solvency, governance, conduct of business) are dealt with in other ICPs with respect to those ICPs' specific areas of focus.

9.0.2 Supervision is a dynamic process that includes:

- developing and implementing a framework for supervisory review and reporting;
- developing and executing supervisory plans for insurers;
- analysis of reported and other relevant information;
- feedback and dialogue between the supervisor and insurers;
- intervention, including any preventive/corrective measures or sanctions, where necessary;
- follow-up (including updating the supervisory framework and/or adjusting the frequency and intensity of assessment under supervisory plans); and
- cooperation and coordination with other relevant supervisors and authorities where necessary.

CF 9.0.a The group-wide supervisor engages with the Head of the IAIG and, in cooperation with other involved supervisors, carries out a supervisory review to assess the IAIG's compliance with relevant legislation and supervisory requirements applicable at the level of the Head of the IAIG.

CF 9.0.a.1 This supervisory review may be conducted within the supervisory college (see ComFrame material under ICP 25 Supervisory Cooperation and Coordination).

CF 9.0.a.2 Cooperation with other involved supervisors includes them providing relevant information concerning the insurance legal entities within the IAIG that they supervise. It is the responsibility of the group-wide supervisor to assess the IAIG's compliance with the relevant

legislation and supervisory requirements applicable at the level of the Head of the IAIG.

Framework for supervisory review and reporting

9.1 The supervisor has a documented framework which outlines its approach for supervisory review and reporting. The supervisor reviews periodically that this framework remains effective and adequate.

9.1.1 While the framework should encompass all insurers within a jurisdiction, it should be sufficiently flexible with varying supervisory review and reporting requirements that allow for taking a risk-based approach. For example, the supervisory processes and activities which are appropriate for a complex, internationally active insurer may be different than those for a small, local insurer.

9.1.2 The supervisor should have documented procedures and/or guidelines for consistent and regular supervisory review and reporting at an appropriate level of depth.

9.1.3 The supervisor should be able to process data in a timely and effective way and have processes and procedures to collect and store reported data securely in an electronic format. The framework should have the necessary protections for confidential information in the possession of the supervisor and for the sharing of information (see ICP 2 Supervisor and ICP 3 Information Sharing and Confidentiality Requirements).

9.1.4 The framework should enable the supervisor to coordinate on-site inspection and off-site monitoring activities. The supervisor should document the results of these activities in such a way that they are accessible and comprehensible to all involved staff.

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

9.1.6 The framework should enable the supervisor to evaluate the insurer's business, financial condition, conduct of business and corporate governance framework to determine the insurer's overall risk profile. In order to achieve this objective, the supervisor should have an understanding of at least the insurer's:

- current and prospective solvency, including assets and liabilities and off-balance sheet commitments;
- capital resources management;
- technical operations (eg actuarial methods, underwriting policy, reinsurance policy);
- treatment of customers and whether any activities being engaged in are not fair, lawful or proper;
- corporate culture, business objectives and strategies and business models;
- the systems of risk management and internal controls;

- organisational structure; and
- compliance with supervisory requirements.

9.1.7 The supervisor should assess the insurer's enterprise risk management framework for the identification and quantification of risks, and evaluate whether business activities and/or internal practices/processes reflect the insurer's risk assessment. The supervisor should compare the risk profile of the insurer with its risk-carrying capacity and seek to detect issues that may adversely affect its capacity to meet obligations towards policyholders. The framework should enable the supervisor to analyse trends and compare risk assessments including against any stress test outcomes.

9.1.8 The framework should include assessments of the risks to which insurers are exposed and the risks which insurers may pose to policyholders, the insurance sector and financial stability. These assessments should include risks which may lead to an insurer's distress or disorderly failure or which may be transmitted through collective activities or exposures of a number of insurers and that may have a serious negative impact on financial stability (see ICP 24 Macroprudential Supervision).

9.1.9 The framework should include sufficiently comprehensive and regular communication between the supervisor and insurers. This communication should involve senior level representatives as well as specialised areas within both the supervisor and insurers, and for insurance groups, may include contact with non-regulated and parent entities. Additionally, there should be appropriate communication channels between the supervisor and the external auditors for the exchange of information relevant to carrying out their respective statutory responsibilities.

9.1.10 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.

Review of the Framework

9.1.11 The supervisor's review of its framework should pay due attention to the evolving risks which may be posed by insurers and to risks to which insurers may be exposed.

9.1.12 As part of the framework review, the supervisor should confer regularly internally as well as externally with other relevant authorities and stakeholders so that all relevant information is being appropriately assessed and analysed, and to facilitate the identification of potential new risks or emerging market trends that the framework may need to address. While the framework should be updated accordingly, the supervisor should be mindful that such updates are not done so frequently or in a manner that causes unnecessary disruption to the supervisory process and/or excessive costs to the supervisor and insurers.

9.1.13 The framework should be suitably flexible so that it may adapt easily and in a timely manner to domestic and global developments in, for example, legislation, the insurance and broader financial markets, or international standards.

Group Perspectives

9.1.14 The framework of the group-wide supervisor should take into account all entities identified within the scope of the insurance group (see ICP 23 Group-wide Supervision). While insurance groups may have different approaches to governance structures – either more centralised or more decentralised – the framework should include appropriate tools for supervisory review and reporting for all relevant entities (see Issues Paper on Approaches to Group Corporate Governance).

9.1.15 Although the group-wide supervisor may not have the power to conduct supervisory review and reporting of non-regulated entities, it should assess, at least, the potential adverse impact of such non-regulated entities on the group.

9.1.16 Similarly, where the group-wide supervisor does not have the power to conduct supervisory review and reporting of a group legal entity in another jurisdiction, it should communicate and coordinate with the other involved supervisor accordingly. For example, the group-wide supervisor could approach the other involved supervisor to propose a joint on-site inspection or recommend that the other involved supervisor undertake such an inspection, when deemed necessary.

9.2 As part of the supervisory framework, the supervisor develops supervisory plans which set priorities and determine the appropriate depth and level of off-site monitoring and on-site inspection activity.

9.2.1 A supervisory plan is a tool for supervisors to determine the frequency, scope and depth of supervisory review activities. It could be generic (eg addressing categories or groups of insurers) or specific (addressing individual insurers).

9.2.2 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.

9.2.3 The circular nature of the supervisory framework provides a variety of inputs to help develop and/or adjust supervisory plans. For example, market analyses, internal models, insurers' own risk and solvency assessments (ORSA), horizontal reviews, stress/scenario testing, previous risk and conduct assessments, work of external auditors and information gathered as a result of supervisory reporting requirements provide information the supervisor should use as input in determining the scope and frequency of off-site monitoring and on-site inspections.

Group-wide supervisory plan and risk assessment

CF 9.2.a The group-wide supervisor's supervisory plan for an IAIG includes a group-wide risk assessment that is conducted at least annually.

CF 9.2.a.1 The group-wide risk assessment of an IAIG should be conducted with inputs from the supervisory process.

CF 9.2.a.2 The group-wide supervisor should consider the results of the IAIG's enterprise risk management framework including its ORSA assessment, as part of the group-wide risk assessment.

CF 9.2.a.3 The group-wide supervisor should use information gathered on legal entities within the IAIG from other involved supervisors as another basis for the assessment of group-wide risk. Where other involved supervisors identify risks that may be relevant to the supervision of the IAIG at the group level, they should share their individual risk assessment.

CF 9.2.a.4 The group-wide supervisor should consider inputs from other relevant supervisors not involved in the direct supervision of the IAIG such as macro-prudential analysis, anti-money laundering or combatting the financing of terrorism.

Peer-group analysis

CF 9.2.a.5 To the extent practicable and where useful, the group-wide supervisor should conduct an analysis of the IAIG's peers as part of the group-wide risk assessment, in cooperation with group-wide supervisors of other IAIGs. Information in the public domain should be used for the purposes of the peer-group analysis. The group-wide supervisor may also use non-public information provided by other supervisors. If sharing non-public information for the purpose of the peer-group analysis, the group-wide supervisor should be conscious of the risk of sharing information that in certain situations could compromise the competitive advantage of the IAIG's peers. The group-wide supervisor should consider whether it is appropriate to anonymise information shared.

CF 9.2.a.6 In conducting peer group analysis, the group-wide supervisor should consider issues such as:

- the similarity of business models and geographical scope of IAIGs;
- the size, type and structure of IAIGs; and
- internal IAIG practices and governance, including risk management.

CF 9.2.a.7 It is the group-wide supervisor's responsibility to decide to what extent the outcomes of peer-group analysis are shared with other involved supervisors. Peer-group analysis is subject to confidentiality requirements (see ICP 3 Information Sharing and Confidentiality Requirements).

CF 9.2.b The group-wide supervisor includes in its group-wide risk assessment of an IAIG, at least, an evaluation of the following:

- **the complexity of the IAIG's group structure and the resulting risks to effective group-wide supervision;**
- **the capital adequacy and the availability of capital to meet group-wide capital requirements taking into account the regulatory capital requirements for each insurance legal entity within the IAIG; and**

- **the impact of the complexity of the IAIG's group structure on the effectiveness of its group-wide corporate governance framework.**

CF 9.2.b.1 In conducting the group-wide risk assessment, the group-wide supervisor should consider:

- the alignment between the IAIG's competitive position, business plans and strategy, risk appetite, and risk-carrying capacity;
- the IAIG's approach to its legal and regulatory obligations, its product distribution model and its proposals for dealing with specific areas of risk;
- non-regulated and non-financial legal entities within the IAIG;
- the adequacy and outcomes of the IAIG's stress testing and scenario analysis (see ICP 16 Enterprise Risk Management for Solvency Purposes);
- the IAIG's ability to meet policyholder obligations in both the near and long-term within the context of the risks arising from the macro environment in which the IAIG's operates; and
- the potential impact that the IAIG's distress or disorderly failure would have on policyholders, the insurance sector, and financial stability, as well as the impact from the IAIG's contribution to collective activities or exposures that may have a serious negative impact on financial stability.

Complexity

CF 9.2.b.2 In conducting the group-wide risk assessment, the group-wide supervisor should consider:

- aggregated risk exposures that the IAIG has towards external counterparties, which can arise from direct and indirect exposures, on-balance and off-balance sheet items, regulated and non-regulated legal entities within the IAIG, the same or different financial sectors across the IAIG, or a combination or interaction of such exposures. The group-wide supervisor should evaluate if the Head of the IAIG has adequate oversight and has implemented an adequate risk management system to assess its aggregated credit, market, insurance and liquidity risk concentrations. Such risk concentrations should be viewed in the context of single or closely related drivers of risk that may have material impact on the IAIG;
- increased operational risk where the IAIG relies on significant cross-border services or support. Such cross-border activity may also increase the complexity of recovery and resolution planning. The group-wide supervisor should evaluate the effectiveness of the IAIG's

policies, processes and systems, and assess whether the IAIG has adequate business continuity plan arrangements to mitigate such cross-border operational risk; and

- significant intra-group transactions which can give rise to contagion effects within the IAIG, or result in a circumvention of sectoral regulatory requirements. The group-wide supervisor should evaluate whether the Head of the IAIG has adequate oversight over all material intra-group transactions.

Capital adequacy

CF 9.2.b.3 In conducting the group-wide risk assessment, the group-wide supervisor should assess the adequacy of an IAIG's capital position against group capital standards applicable at the level of the Head of the IAIG. The role of the group-wide supervisor in conducting and coordinating this assessment is particularly important in cases where the IAIG has a mixture of insurance, banking and securities sector operations.

CF 9.2.b.4 In conducting the group-wide risk assessment, the group-wide supervisor should identify situations that may give rise to double or multiple gearing. Such situations may occur within IAIGs which are not fully consolidated and when one legal entity holds regulatory capital issued by another entity within the IAIG, where the issuer is permitted to include the capital in meeting its own regulatory requirements. These situations can result in an overstatement of group capital. The group-wide supervisor should require that the capital adequacy assessments of the IAIG exclude intra-group holdings of regulatory capital if not performed on a fully consolidated basis.

CF 9.2.b.5 In conducting the group-wide risk assessment, the group-wide supervisor, in cooperation with other involved supervisors, should assess the fungibility of capital (its ability to absorb losses arising anywhere in the IAIG as needed). The group-wide supervisor should take into account regulatory, legal and other requirements that may affect the IAIG's ability to transfer capital between entities, sectors and jurisdictions, both in normal circumstances and in a crisis.

Non-regulated and non-financial legal entities

CF 9.2.b.6 In conducting the group-wide risk assessment, the group-wide supervisor should consider the activities undertaken by non-regulated legal entities within the IAIG by assessing issues such as:

- the potential contagion risks arising from the activities of non-regulated legal entities due to interdependencies or exposures between the insurance legal entities and the non-regulated legal entities within the IAIG;
- the competence of the IAIG Board and Senior Management in understanding and managing the risks arising from the non-regulated legal entities, particularly if these entities are significant to the group;

- the strength of the group capital adequacy to support the insurance legal entities. Non-regulated legal entities' contribution to the group capital adequacy could be assessed by calculation of a proxy capital requirement as if the legal entity were regulated or through deduction of the group's interest in the non-regulated legal entity; and
- where risk has been transferred from regulated to non-regulated legal entities within the IAIG, the group-wide supervisor in cooperation with supervisors of the regulated entities should look through to the overall quantum and quality of assets in the non-regulated entities. The risk assessment should address third party participations and minority interests.

Stress testing

CF 9.2.b.7 In conducting the group-wide risk assessment, the group-wide supervisor should evaluate the results of group-wide stress tests that the IAIG performed.

Macroprudential analysis

CF 9.2.b.8 In conducting the group-wide risk assessment, the group-wide supervisor, with input from other involved supervisors, should consider the current and forecasted business and the macroeconomic environment in the material jurisdictions in which the IAIG operates. The group-wide supervisor should assess the cumulative potential impact from this on the operations of the IAIG as well as the impact of the IAIG's distress, disorderly failure, or its contribution to collective activities or exposures, on financial stability. This analysis by the group-wide supervisor should also be incorporated into forward-looking stress testing to identify possible events or changes in market conditions.

9.3 The supervisor reviews outsourced material activities or functions to the same level as non-outsourced material activities or functions.

9.3.1 The supervisor should review outsourced material activities or functions through the insurer itself, but should also obtain information from, and conduct on-site inspections of, entities engaged in providing outsourced activities or functions for the insurer, where necessary.

9.3.2 The supervisory review process for outsourced material activities or functions may differ from the process used for non-outsourced activities or functions, provided that the supervisory outcomes are met.

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

Supervisory reporting

9.4 The Supervisor:

- **establishes documented requirements for the regular reporting of qualitative and quantitative information from all insurers licensed in its jurisdiction;**

- **defines the scope, content and frequency of the information to be reported;**
- **sets out the relevant accounting and auditing standards to be used;**
- **requires that an external audit opinion is provided on annual financial statements;**
- **requires insurers to report on any material changes or incidents that could affect their condition or customers;**
- **requires insurers to correct inaccurate reporting as soon as possible; and**
- **requires more frequent reporting and/or additional information from insurers as needed.**

9.4.1 Supervisory reporting requirements should apply to all insurers licensed in a jurisdiction, and form the general basis for off-site monitoring. Supervisory reporting requirements are a reflection of the supervisor's needs and will thus vary by jurisdiction according to overall market structure and conditions and by insurer according to its nature, scale and complexity.

9.4.2 In setting supervisory reporting requirements, the supervisor may make a distinction for foreign insurers who are 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.

9.4.3 The supervisor should require insurers to report both quantitative and qualitative information, including at least:

- financial reports, which include at least a balance sheet and income statement as well as a statement of comprehensive income if appropriate;
- an external audit opinion on annual financial statements;
- off-balance sheet exposures;
- material outsourced functions and activities;
- a description of the insurer's organisational structure, corporate governance framework and risk management and internal control systems; and
- information on complaints, claims, surrenders and lapses.

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

9.4.5 The supervisor may require that certain reports and information, such as solvency ratios or technical provisions, are subject to independent (internal or external) review, including audit and/or actuarial review.

9.4.6 While the supervisor sets out the relevant accounting and auditing standards to be used for supervisory reporting, the actual standards are generally established by a party other than the supervisor. To help

accounting and auditing standards reflect the nature of insurance business, the supervisor could provide guidance and practices to be used for areas such as fair value estimations and technical provisions.

9.4.7 The external audit of the annual financial statements should be conducted in accordance with auditing standards that are generally accepted internationally.

9.4.8 The supervisor should consider using the work of external auditors in order to support the supervisory review process. For example, the supervisor may utilize the external audits to identify: internal control weaknesses and possible audit material risks; issues resulting from regulatory and accounting changes; changes in insurance and financial risks; and issues encountered in applying the audit approach.

9.4.9 The supervisor should require the external auditor to report matters that are likely to be of material significance without delay. Such matters would include (indication of) material fraud and regulatory breaches or other significant 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.

9.4.10 Depending on the nature, scale and complexity of the insurer, more frequent reporting and/or additional information may be requested from specific insurers on a case-by-case basis.

9.4.11 The supervisor should require that information on changes that could materially impact the insurer's risk profile, financial position, organisational structure, governance or treatment of its customers is provided by the insurer in a timely manner.

9.4.12 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. Assessing the results of off-site monitoring and on-site inspections may help inform such a review.

Group Perspectives

9.4.13 The supervisor should require an insurance legal entity 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 insurance group, and on the nature and volume of material intra-group transactions. The supervisor may require information on the impact on the insurance legal entity of being part of an insurance group.

9.4.14 The supervisor may request and obtain relevant information about any entity within an insurance group, subject to applicable legal provisions and coordination with the supervisors of affected jurisdictions.

9.4.15 The group-wide supervisor should establish its supervisory reporting requirements on a group-wide basis in coordination with the other involved supervisors. Such coordination may help the group-wide supervisor understand what information is being reported and avoid any

gaps as well as facilitate the submission of information on group entities in other jurisdictions.

9.4.16 In order to better understand the group and its risks, the group-wide supervisor should require the group to submit information on the group structure, business operation and financial position of material entities within the insurance group and relationship among entities within the insurance group, including participation in other group entities and material intra-group transactions.

CF 9.4.a The group-wide supervisor requires the Head of the IAIG to report the reference ICS and, at the option of the group-wide supervisor, any additional reporting related to the ICS.

CF 9.4.a.1 Reporting to the group-wide supervisor should be on a confidential basis for the purpose of discussion in the supervisory college.

Off-site monitoring

9.5 The supervisor monitors insurers on an ongoing basis, based on communication with the insurer and analysis of information obtained through supervisory reporting as well as market and other relevant information.

9.5.1 The supervisor should be proactive and forward-looking in conducting effective off-site monitoring, and not rely only on historical data. The supervisor should analyse information obtained in a timely manner.

9.5.2 The results of off-site monitoring should influence the supervisory plan and help determine the content, nature, timing and frequency of on-site inspections. Off-site monitoring may also enable the early detection of problems so that prompt and appropriate supervisory responses can be taken before such problems become more serious.

9.5.3 Analysis by the supervisor may provide a deeper understanding of developing trends affecting an insurer and its customers. Analysis by business lines, customer grouping and/or distribution channels may provide insights into the insurer's overall risk profile.

9.5.4 The supervisor should establish and follow documented procedures for the analysis and monitoring of the supervisory reporting that it receives. These may be conducted by individual supervisory staff using monitoring tools and/or specialised resources, as appropriate.

9.5.5 Examples of ways in which this Standard and its corresponding guidance can be pursued include the following [see text in Annex].

On-site inspection

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

9.6.1 On-site inspections help the supervisor to identify strengths and weaknesses within an insurer, and to assess and analyse the risks to which an insurer and its customers are exposed.

9.6.2 On-site inspections may supplement the analysis from off-site monitoring and provide the supervisor with 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. It is important that on-site inspections are coordinated with off-site monitoring to increase efficiency and avoid duplication of work.

9.6.3 On-site inspections should be tailored to the particular insurer and its risks. However, an on-site inspection work programme should remain flexible since new priorities might arise.

9.6.4 The on-site inspection work programme should take account of the insurer's distribution model, the nature, size and profile of its customer base and its relative importance in the market. On-site inspections should be more frequent and more in- depth for 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.

9.6.5 The supervisor may use independent experts (see ICP 2 Supervisor) to conduct part of an on-site inspection, for instance when additional resources or specific expertise is needed.

9.6.6 The supervisor can conduct on-site inspections on either a broad or targeted basis. The purpose of a broad on-site inspection is to assess the overall condition, activities and risk-profile of the insurer. A targeted on-site inspection is focused on a specific area or areas of an insurer, such as a particular key activity or process. Targeted on-site inspections can also be carried out across a number of insurers based on a specific theme, activity or risk (sometimes called "thematic reviews"). Targeted on-site inspections can be very effective in focusing supervisory resources quickly on those areas requiring immediate attention. If a targeted on-site inspection leads to other areas of supervisory concern, the supervisor may determine that a broad on-site inspection is necessary.

9.6.7 Advance notice is normally given to the insurer before the supervisor conducts an on-site inspection so that both parties may plan accordingly. However, the supervisor may decide not to provide advance notice in certain circumstances.

9.6.8 Examples of ways in which this Standard and its corresponding guidance can be pursued include the following [see text in Annex].

CF 9.6.a The group-wide supervisor performs on-site inspections at the level of the Head of the IAIG.

CF 9.6.a.1 The group-wide supervisor's on-site inspections should consider group-wide activities and major risks that impact legal entities within the IAIG.

CF 9.6.a.2 During on-site inspections, the group-wide supervisor should have access to the IAIG Board, Senior Management and Key Persons in Control Functions responsible for the group-wide functions wherever these functions are performed. Where the group-wide functions are performed by an insurance legal entity within the IAIG, which is outside the jurisdiction of the group-wide supervisor, the group-wide

supervisor should inform the relevant other involved supervisor prior to approaching this insurance legal entity as part of the on-site inspection carried out at the level of the Head of the IAIG.

CF 9.6.a.3 Other involved supervisors should inform the group-wide supervisor of significant planned on-site inspections and communicate the main findings to the supervisory college where they are material to the IAIG or to another insurance legal entity within the IAIG.

CF 9.6.b Where appropriate, the group-wide supervisor, or other involved supervisors with reasonable supervisory interest, join on-site inspections of an insurance legal entity in another jurisdiction, coordinated by the relevant involved supervisor, with prior consent from that supervisor.

CF 9.6.b.1 Relevant involved supervisors should consider organising a joint on-site inspection to address issues that are material to the IAIG or to another insurance legal entity within the IAIG. The relevant involved supervisor should share the main outcomes of a joint on-site inspection within the supervisory college.

Supervisory feedback and follow-up

9.7 The supervisor discusses with the insurer as soon as practical any relevant findings of the supervisory review and the need for any preventive or corrective measures.

9.7.1 The supervisor should provide appropriate feedback in a timely manner to the insurer during the ongoing supervisory review process. The supervisor should issue in writing the findings of the review and the actions required. In many circumstances, the supervisor's initial action will be to discuss the issue with the insurer, which may resolve the issue and require no further action. However some issues may require preventive or corrective measures, and in some cases imposing sanctions (see ICP 10 Preventive Measures, Corrective Measures and Sanctions).

9.7.2 Whether and how the insurer has subsequently addressed issues identified by the supervisor should be considered in the evaluation of the insurer and should be factored into the ongoing supervisory plan.

CF 9.7.a The group-wide supervisor communicates the results of the group-wide supervisory review of the IAIG, including the group-wide risk assessment, to the supervisory college and, as appropriate, to the Head of the IAIG.

Annex: Examples of ways in which Standards 9.5 and 9.6 and their corresponding guidance can be pursued include the following:

A) The evaluation of the effectiveness of the insurer's 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;
- examining communications provided by the auditors to the Board and/or the Audit Committee, such as the auditors' reports;
- analysing information obtained from and/or received through direct engagement with the external auditor on substantial insights into the insurer's corporate governance framework, control environment, and financial reporting;
- evaluating the suitability of significant owners by analysing the ownership structure and sources of finance/funding;
- evaluating the independence of the Board Members, the suitability 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);
- testing the insurer's internal policies, processes and controls in order to assess compliance with regulations and/or adequacy of these in light of the insurer's risk profile;
- testing 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 organisational structure and the management of the insurer.

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

- analysing business lines, the type of products offered, policyholders and location of business;
- analysing the distribution model(s) used;
- meeting with the management to get information and a deeper understanding about current and future business plans;
- analysing material contracts;
- analysing the sales and marketing policies of the insurer, in particular, policy conditions and remuneration paid to the intermediaries; and
- evaluating the reinsurance cover and its security. In particular, the reinsurance cover should be appropriate with regard 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 instances of cross-subsidisation of businesses within a group or non-arm's length fees and charges;

- analysing agreements with external service providers;
- identifying financial problems originating from an entity in the group to which the insurer belongs; and
- identifying of conflicts of interest arising from intra-group relationships or relationships with external entities.

D) Evaluation of the insurer's financial condition can be done through:

- analysing audited financial statements and off-balance sheet commitments;
- analysing the settlement of claims and the calculation of technical provisions according to current regulations;
- analysing the operations and financial results by line of business;
- analysing the investment policy (including derivatives policy) and the assets held to cover the technical provisions;
- valuation of the insurer's investments;
- assessing litigation in which the insurer is a party; and
- analysing the forecasted balance sheets and profit and loss accounts in relation to 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 remuneration practices demonstrate a culture of fair treatment to customers;
- assessing how conflicts of interests with customers are identified, managed and mitigated;
- reviewing how products are designed and distributed to ensure they fulfil the customers' demands and needs;
- checking the adequacy, appropriateness and timeliness of the information and advice given to customers;
- reviewing the handling and timing of claims and other payments;
- reviewing the handling, frequency and nature of customer complaints, disputes and litigation; and
- reviewing any customer experience reports used by the insurer or from other sources, such as an ombudsman.

ICP 10 Preventive Measures, Corrective Measures and Sanctions

The supervisor:

- **requires and enforces preventive and corrective measures; and**
- **imposes sanctions**

which are timely, necessary to achieve the objectives of insurance supervision, and based on clear, objective, consistent, and publicly disclosed general criteria.

Introductory Guidance

10.0.1 The supervisor should initiate escalating measures to prevent a breach of regulatory requirements by an insurer, respond to a breach of regulatory requirements by an insurer, and enforce those measures to ensure that the insurer responds to the supervisor's concerns. Preventive measures should be used to prevent a breach of regulatory requirements and corrective measures should be used to respond to a breach of regulatory requirements. Functionally, supervisors may take similar or identical actions as preventive or corrective measures. In addition, where a regulatory requirement has been violated, supervisors may use sanctions.

10.0.2 The supervisor should promptly and effectively deal with insurer non-compliance with regulatory requirements or supervisory measures that could put policyholders at risk, could pose a threat to financial stability, or could impinge on any other supervisory objectives. The more significant the threat to policyholders' interests or to financial stability, then the quicker the supervisor will need to act and to require action from the insurer, and the more significant the measures that may be required. By mitigating certain risks, preventive and corrective measures that are primarily intended to protect policyholders may also contribute to financial stability, by decreasing the probability and magnitude of any negative systemic impact.

10.0.3 Circumstances may arise when preventive or corrective measures are insufficient to prevent an insurer from being no longer viable, or likely to become no longer viable, and therefore need to exit the market or be resolved (see ICP 12 Exit from the Market and Resolution).

10.0.4 As part of the supervisory framework (see ICP 9 Supervisory Review and Reporting), the supervisor should consider in advance how to use preventive and corrective measures, enforcement of those measures, and the imposition of sanctions. A supervisor's framework should be documented to assist in the delivery of consistent supervision over time. It is crucial that the framework leaves room for the exercise of supervisory judgement and discretion, so flexibility should be allowed in the use of preventive measures, corrective measures and sanctions. In addition to general criteria, other parts of the framework on preventive measures, corrective measures and sanctions can also be released publicly, particularly where the supervisor feels that this additional transparency will lead to the market functioning more effectively. The decision-making processes that underpin the supervisory framework

should function in a way that allows the supervisor to take immediate action when necessary.

10.0.5 In some instances, the supervisor will need to work with other authorities or bodies in order to take or enforce supervisory measures or sanctions against an insurer. For example, some measures or sanctions will require the approval of a judicial body.

10.0.6 There are different methods by which supervisory outcomes can be achieved. The method chosen may vary depending on the jurisdiction's legal framework. In some jurisdictions, one method is to accept an enforceable written agreement to do, or not to do, some thing or things from the insurer in question. The potential advantages of achieving an outcome by this route are that it can be quicker and less costly. This option can be used to achieve outcomes related to preventive or corrective measures or to sanctions.

Group perspectives

10.0.7 Measures or sanctions targeted at non-insurance legal entities within an insurance group may require the supervisor to work with other regulatory authorities.

10.0.8 The supervisor for an insurance legal entity within an insurance group should inform other involved supervisors when taking supervisory measures against or imposing sanctions on that insurance legal entity, where those sanctions are material or otherwise relevant to those supervisors.

CF 10.0.a The group-wide supervisor applies supervisory measures directly to the Head of the IAIG. If the Head of the IAIG is not within the group-wide supervisor's jurisdiction, other involved supervisors apply supervisory measures to assist the group-wide supervisor.

CF 10.0.a.1 The group-wide supervisor should have flexibility in how it applies supervisory measures, which may need to vary according to the legal structure of the group, the jurisdiction in which the legal entities in the group are established, and the supervisory authority over relevant parts of the group.

CF 10.0.a.2 If the Head of the IAIG is not located in the jurisdiction of the group-wide supervisor, the group-wide supervisor should use indirect powers to apply supervisory measures.

CF 10.0.a.3 Other involved supervisors should assist the group-wide supervisor to apply supervisory measures to the Head of the IAIG or to insurance legal entities if they have direct supervisory powers to do so.

CF 10.0.b An involved supervisor coordinates with other involved supervisors before requiring a specific preventive or corrective measure if that measure will have a material effect on the supervision of the IAIG as a whole, or on the supervision of an insurance legal entity within the IAIG, unless exceptional circumstances preclude such coordination.

CF 10.0.b.1 The supervisory college provides a forum for the group-wide supervisor and other involved supervisors to coordinate preventive and corrective measures. In addition to supervisory colleges,

coordination can take place through a crisis management group (see ComFrame material under ICP 25 Supervisory Coordination and Cooperation).

CF 10.0.b.2 Supervisory measures that should be preceded by coordination between involved supervisors include: restricting the transfer of assets between entities within the IAIG; requiring an increase in capital; and suspending or revoking the licence of an insurance legal entity.

CF 10.0.b.3 There may be exceptional circumstances where an involved supervisor that wishes to act cannot coordinate in advance with the other involved supervisors. In such circumstances, the involved supervisor should inform the other involved supervisors of the decision made, or action taken, and the supporting rationale, as soon as possible.

CF 10.0.b.4 An involved supervisor does not need to coordinate with the other involved supervisors if the preventive or corrective measure will not materially affect the IAIG as a whole or another insurance legal entity. For example, an involved supervisor may not need to coordinate with the other involved supervisors before requiring the insurance legal entity to enhance its regulatory reporting as a preventive measure to monitor the legal entity's specific business.

CF 10.0.b.5 If an involved supervisor requires an insurance legal entity within the IAIG to take preventive or corrective measures that are long-term and material in nature, that supervisor should provide periodic updates to the supervisory college.

CF 10.0.b.6 The requirement to coordinate action (other than in exceptional circumstances) does not imply that the supervisor taking action needs the consent of other involved supervisors to take action which is necessary to discharge its duties under the law in its jurisdiction.

10.1 The supervisor acts against individuals or entities that conduct insurance activities without the necessary licence.

10.1.1 The supervisor should have in place mechanisms to identify when unlicensed insurance activity is being carried out. Examples of such mechanisms include monitoring of media and advertising, review of consumer complaints or encouraging industry and other stakeholders to notify the supervisor of suspicious activity.

10.1.2 Where unlicensed activity is identified, the supervisor should act to address the issue. Examples include requiring the unlicensed entity to apply for a licence, seeking court orders to require the unlicensed entity to stop the activity, informing law enforcement authorities of criminal and/or civil concerns, imposing sanctions on the individual/entity or publicising the fact that the individual and/or entity is/are not licensed to conduct insurance activities.

10.2 The supervisor requires preventive measures if the insurer seems likely to operate in a manner that is inconsistent with regulatory requirements.

10.2.1 Determining when an insurer seems likely to operate in a manner that is inconsistent with regulatory requirements will require a degree of discretion on the part of the supervisor. Nevertheless, concerns that

necessitate preventive measures should be well founded based on the supervisor's assessment.

10.2.2 If the insurer operates in a manner that is likely to impact its ability to protect policyholders' interests or pose a threat to financial stability, the supervisor should act more urgently in requiring preventive measures.

10.2.3 The supervisor should communicate concerns to the insurer with a promptness that reflects the significance of the concern. Some concerns, such as relating to insurer solvency, policyholder protection, or financial stability, will be sufficiently significant to require immediate communication to the insurer. Other concerns, although significant, may not require such rapid communication, but should still be communicated appropriately. For example, it is unlikely to be appropriate for a supervisor to wait for the next on-site visit to an insurer before communicating a significant concern.

10.2.4 The supervisor should promptly bring significant concerns to the attention of the Board because it has ultimate responsibility for the insurer and that such concerns are resolved. In addition, the supervisor should also communicate with Senior Management and with Key Persons in Control Functions to bring significant concerns to their attention.

10.2.5 The supervisor should have available a range of preventive measures broad enough to address insurers of all sizes and complexities. Preventive measures should be chosen to address the severity of the insurer's problems.

10.2.6 The supervisor should have the power to issue, and enforce:

- restrictions on business activities, such as:
  - prohibiting the insurer from issuing new policies or new types of product;
  - requiring the insurer to alter its sales practices or other business practices;
  - withholding approval for new business activities or acquisitions;
  - restricting the transfer of assets;
  - prohibiting the insurer from continuing a business relationship with an intermediary or other outsourced provider, or requiring the terms of such a relationship to be varied;
  - restricting the ownership of subsidiaries; and
  - restricting activities of a subsidiary where, in its opinion, such activities jeopardise the financial situation of the insurer;
- directions to reinforce the insurer's financial position, such as:
  - requiring measures that reduce or mitigate risks (for example, restricting exposures, through either hard or soft limits, to individual counterparties, sectors, or asset classes);

- requiring an increase in capital;
- restricting or suspending dividend or other payments to shareholders; and
- restricting purchase of the insurer's own shares; and

- other directions, including:
  - requiring the reinforcement of governance arrangements, internal controls or the risk management system;
  - requiring the insurer to prepare a report describing actions it intends to undertake to address specific activities the supervisor has identified, through macroprudential surveillance, as potentially posing a threat to financial stability (see ICP 24 Macroprudential Supervision);
  - facilitating the transfer of obligations under the policies from a failing insurer to another insurer that accepts this transfer;
  - suspending the licence of an insurer; and
  - barring individuals acting in key roles from such roles in future.

10.2.7 The supervisor may also have other powers available, including:

- temporarily delaying or suspending, in whole or in part, the payments of the redemption values on insurance liabilities or payments of advances on contracts;
- lowering the maximum rate of guarantees for new business or introducing additional reserving requirements; or
- incentivising the use of a system-wide lending facility, when available, for market-wide liquidity issues extending to insurers.

10.2.8 The supervisor should take steps to address problems arising from Board Members, Senior Management, Key Persons in Control Functions, significant owners, external auditors and any other person who plays a significant role within the insurer. For example, the supervisor should require the insurer to replace or restrict the power and role of those involved (listed above) in the governance processes if the supervisor has material concerns with management or governance.

10.2.9 The supervisor should reject, rescind and/or request a court to revoke the appointment of an external auditor who is deemed to have inadequate expertise or independence, or is not subject to, or does not adhere to, established professional standards.

10.2.10 Supervisors should take action to address insurer audit quality concerns, including, where possible, requiring replacement or appointment of a supplementary auditor and the sanctioning of an external auditor if necessary. Supervisors should watch for indicators of potential major audit quality concerns, such as when:

- the auditor does not have adequate insurance industry knowledge and competence;

- there is an identified issue with auditor objectivity and independence;
- the auditor does not disclose to the supervisor matters that it is required to disclose;
- clear audit quality concerns are identified, such as if the auditor fails to test internal control systems sufficiently, the auditor is not appropriately sceptical, or does not appropriately challenge the insurer's management regarding the major accounting figures; or
- the auditor's system of internal quality control appears ineffective.

CF 10.2.a The group-wide supervisor requires the Head of the IAIG to take preventive measures if:

- **a legal entity within the IAIG seems likely to operate in a manner that would have a material adverse effect on the IAIG as a whole; or**
- **the IAIG as a whole seems likely to operate in a manner that is inconsistent with regulatory requirements.**

CF 10.2.a.1 The situation described in the first part of the Standard could arise, for example, where one regulated legal entity in the group seems likely to fail to meet its capital requirement, causing the IAIG as a whole to be likely to fail to meet a group capital requirement to which it is subject.

CF 10.2.a.2 The group-wide supervisor should not require the Head of the IAIG to take additional preventive measures if the supervisor of an insurance legal entity within the IAIG has already required that entity to take preventive measures and the group-wide supervisor has assessed that the preventive measures adequately mitigate the risk to the IAIG as a whole.

CF 10.2.a.3 The situation described in the second part of the Standard could arise, for example, where every regulated legal entity in the IAIG meets its capital requirement, but the group as a whole seems unlikely to meet a group capital requirement to which it is subject.

10.3 The supervisor requires corrective measures if the insurer fails to operate in a manner that is consistent with regulatory requirements.

10.3.1 The Guidance under Standard 10.2 is equally applicable when considering corrective measures.

10.3.2 In addition to the supervisory tools set out in 10.2.6, when considering corrective measures the supervisor may find it necessary, in cases of serious breach of regulatory requirements, to revoke the licence of an insurer. The supervisor should be able to enforce this decision.

10.4 The supervisor:

- **requires the insurer to take actions that address the supervisor's identified concerns;**

- **periodically checks that the insurer is taking action; and**
- **assesses the effectiveness of the insurer's actions.**

10.4.1 The supervisor should require the insurer to prepare a plan to resolve the concerns within an acceptable timeframe. The plan should include actions proposed by the insurer or preventive or corrective measures required by the supervisor. What is acceptable as a timeframe will depend on the circumstances of the concerns raised.

10.4.2 If the insurer does not prepare an acceptable plan in a specified timeframe to respond to the supervisor's concerns, the supervisor should impose such a plan on the insurer.

10.4.3 The supervisor should review the results of the actions that the insurer has taken. The supervisor should review both whether the actions have been taken and, if so, the effectiveness of the actions.

10.4.4 The supervisor may require assurance from an independent reviewer regarding adequate resolution of significant concerns. In such cases the supervisor may also require that such an independent reviewer be appointed at the expense of the insurer.

10.5 The supervisor escalates, including enforcing, preventive or corrective measures if its concerns are not addressed by the insurer's actions.

10.5.1 The supervisor should require further measures if its concerns with the insurer become worse, including if the insurer fails to take the actions in a plan.

10.5.2 Supervisory measures should escalate in line with the supervisor's concerns about the insurer. If the insurer's inaction leads to an increased risk to policyholders, then the supervisor should respond by requiring stronger measures to mitigate this risk.

10.5.3 Enforcement of preventive or corrective measures could involve the supervisor issuing a formal direction to an insurer to take particular actions or to cease conducting particular activities. It could also involve the supervisor seeking the assistance of other authorities, or the courts, to enforce a measure.

CF 10.5.a The group-wide supervisor coordinates with other involved supervisors if the Head of the IAIG, or an insurance legal entity within the IAIG, fails to take action to address the group-wide supervisor's, or other involved supervisor's, identified concerns.

CF 10.5.b Where an insurance legal entity within the IAIG fails to take preventive or corrective measures, as required by the involved supervisor, the group-wide supervisor informs the Head of the IAIG of that lack of compliance and assists the involved supervisor, to the extent possible, in achieving compliant outcome.

10.6 The supervisor imposes sanctions on insurers and individuals proportionate to the breach of regulatory requirements or other misconduct.

10.6.1 The supervisor should be able to impose a range of sanctions, which could be administrative, civil or criminal in nature. These can include the

ability to impose fines, the ability to bar individuals acting in key roles from holding similar roles in future, and the ability to require remediation (such as requiring compensation of policyholders in cases of mis-selling). It is recognised that supervisors will not always be able to take a full range of legally binding actions themselves and may need to act in conjunction with, or refer matters to, other authorities, in particular, in the case of criminal penalties.

10.6.2 In some cases it may be appropriate to apply sanctions against insurers or individuals when justified by their actions, or inactions.

10.6.3 The supervisor should, in particular, be able to impose 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;
- deliberately misreport to the supervisor; or
- do not act in accordance with orders or directions imposed on the insurer.

10.6.4 The sanctions imposed by the supervisor should be commensurate with the nature and severity of the insurer's non-compliance with regulatory requirements. Administrative or procedural breaches will generally attract less severe sanctions than breaches arising from an insurer's intentional disregard of regulatory requirements. The sanction imposed should be sufficiently dissuasive so that the insurer, or other insurers, do not commit a similar breach in the future.

10.6.5 The supervisor should impose more severe sanctions relative to the gravity of the breach where an insurer's history demonstrates a pattern of non-compliance with regulatory requirements.

10.6.6 The supervisor may impose sanctions on insurers or individuals in addition to supervisory measures or in the absence of supervisory measures.

10.6.7 The imposition of sanctions against an insurer or an individual typically should not delay either supervisory measures or insurer action taken in response to supervisory measures. However, in some instances, the nature of the sanctions may delay supervisory measures. For example, where a supervisor sanctions an insurer by requiring a number of Senior Managers to be replaced with new individuals, supervisory measures intended to improve the governance of the insurer may not be practical until after the new individuals are appointed.

10.6.8 The supervisor, or another responsible authority in the jurisdiction, should take action to enforce sanctions that have been imposed.

10.6.9 The supervisor should sanction insurers and individuals within a consistent framework, so that similar violations and weaknesses attract similar sanctions. Supervisors should consider how proposed sanctions relate to previous cases. The supervisor should identify precedents where the supervisor has sanctioned an insurer or individual for similar actions/inactions. Where the supervisor has sanctioned an insurer or

individual for similar actions/inactions, then the supervisor should consider carefully whether a comparable sanction is appropriate. If the supervisor concludes that a very different sanction is appropriate, the supervisor should be prepared to explain why it reached this conclusion.

10.6.10 In order for sanctions to have a deterrent effect on other insurers, the fact of the sanction, and sufficient details of the breach, should in general be published. However, the supervisor should retain the discretion to take a different course of action (for example, not to publish, or to delay publication) where this would further the achievement of supervisory objectives or it is otherwise in the public interest to do so.

CF 10.6.a The group-wide supervisor imposes sanctions directly on the Head of the IAIG within the group-wide supervisor's jurisdiction.

CF 10.6.a.1 Available sanctions should include the imposition of fines and penalties (even if non-compliance by the Head of the IAIG is due to the actions of a legal entity within the IAIG).

CF 10.6.a.2 The group-wide supervisor should have flexibility in how it imposes sanctions, which may need to vary according to the legal structure of the group, the jurisdiction in which the legal entities in the group are established, and the supervisory authority over relevant parts of the group.

CF 10.6.a.3 If the Head of the IAIG is not located in the jurisdiction of the group-wide supervisor, the group-wide supervisor should use indirect powers to impose sanctions.

CF 10.6.b An involved supervisor communicates with other involved supervisors before imposing sanctions on:

- **an insurance legal entity;**
- **the Head of the IAIG; or**
- **an individual involved with the relevant insurance legal entity or the Head of the IAIG**

if the sanction will have a material effect on the supervision of the IAIG as a whole or a material effect on the supervision of another insurance legal entity within the IAIG, unless exceptional circumstances preclude such communication.

CF 10.6.b.1 The involved supervisor should communicate the need for sanctions to other involved supervisors at the earliest opportunity. Where an involved supervisor must act before communicating the need for sanctions, that supervisor should inform the group-wide supervisor and other involved supervisors of the sanction, and the supporting rationale, as soon as possible.

ICP 11

There is no longer an ICP 11

ICP 12 Exit from the Market and Resolution

Legislation provides requirements for:

- **the voluntary exit of insurers from the market; and**
- **the resolution of insurers that are no longer viable or are likely to be no longer viable, and have no reasonable prospect of returning to viability.**

Introductory Guidance

12.0.1 An orderly process for an insurer's withdrawal from the business of insurance helps to protect policyholders, and contributes to the stability of the insurance market and the financial system. Jurisdictions should have transparent and effective regimes for an insurer's exit from the market and the resolution of an insurer.

12.0.2 In this ICP, "resolution" refers to an action taken by a resolution authority towards an insurer that is no longer viable, or is likely to be no longer viable, and has no reasonable prospect of returning to viability. Resolution actions include portfolio transfer, run-off, restructuring, and liquidation.

12.0.3 In this ICP, the term "resolution authority" refers to authorities that are responsible for exercising resolution powers over insurers. Depending on the jurisdiction, this term may include supervisors, other governmental entities or private persons (including administrators, receivers, trustees, conservators, liquidators, or other officers), or courts authorised by law to exercise resolution powers. Thus in this ICP:

- "supervisor" is used when the standard and/or guidance involves responsibilities and/or roles of the day-to-day supervisor of the insurer;
- "resolution authority" is used when the standard and/or guidance involves resolution powers and/or processes after resolution has been instituted: this includes supervisors acting under their resolution powers; and
- "supervisor and/or resolution authority" is used when the standard and/or guidance involves responsibilities for planning and/or initiation of resolution and encompasses supervisors acting in their pre-resolution roles (eg before a supervisor or resolution authority institutes resolution and/or obtains any necessary administrative and/or judicial approvals to do so).

12.0.4 The structure and roles of resolution authorities vary across jurisdictions. In some jurisdictions, the resolution authority and the supervisor may be one single authority; in other jurisdictions, resolution of insurers may be the responsibility of one or more separate authorities. In some jurisdictions certain resolution powers may be exercised or overseen by the court. Whatever the allocation of responsibilities, a transparent and effective resolution regime should clearly delineate the responsibilities

and powers of each authority involved in the resolution of insurers (see ICP 1 Objectives, Powers and Responsibilities of the Supervisor). Where there are multiple authorities responsible for the resolution of insurers, the resolution regime should empower the relevant authorities to cooperate and coordinate with each other.

12.0.5 Exit from the market refers to cessation of the insurer's business, in part or in whole. Insurers that meet regulatory requirements may decide to exit from the market on a voluntary basis for business and/or strategic reasons. This is often referred to as 'voluntary exit from the market'.

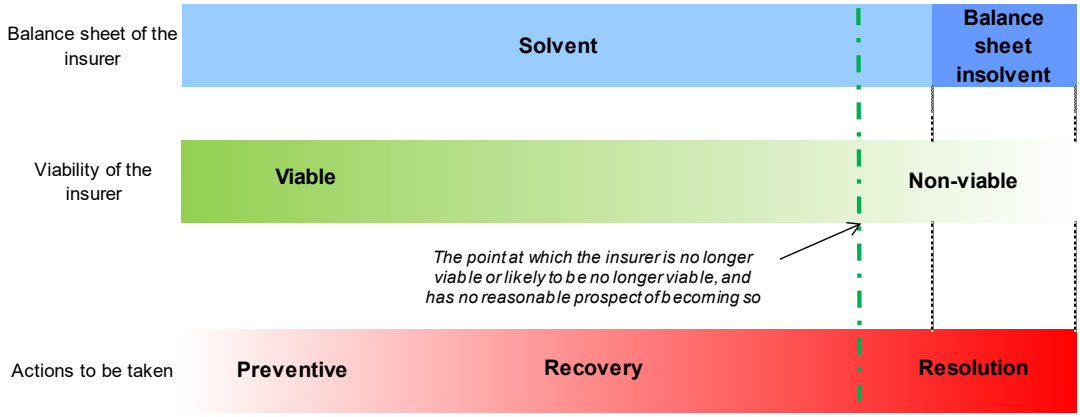
12.0.6 Insurers may also be required by the supervisor to exit from the market. For example, supervisory measures and/or sanctions may result in an insurer exiting from the market (ie involuntary exit from the market) (see ICP 10 Preventive Measures, Corrective Measures and Sanctions).

12.0.7 Jurisdictions may need to have mechanisms in place to determine whether the continuity of insurance cover is necessary when insurers exit from the market. Any such continuity should preferably be on the same contract terms, but when necessary, on amended terms. Such mechanisms need to be proportionate to the unique nature and structure of the insurance market in each jurisdiction. Continuity of insurance cover may be facilitated by transferring insurance portfolios to a succeeding insurer, including a bridge institution. Continuity of some insurance contracts, particularly for some non-life products, may be necessary for only a short period (for example 30 or 60 days) so that the policyholder has sufficient time to find another insurer. Facilitating continuity of insurance cover might not be necessary for certain types of insurance products, such as those that are offered by many insurers in a market and which are highly substitutable.

12.0.8 Where an insurer exits from the market and there is no succeeding insurer or no similar insurance products available in the market, mechanisms that facilitate the availability of alternate cover may need to be explored by the supervisor, such as when the exiting insurer delivers insurance contracts that cover risks that may be important to a particular jurisdiction's economy and/or are compulsory insurance in legislation.

12.0.9 Insurers that are no longer viable or likely to be no longer viable and have no reasonable prospect of becoming so through their recovery action or supervisory measures, should be resolved. Figure 12.1 illustrates in a stylised way the relationship between solvency, viability and the nature of actions to be taken. No uniform, single fixed point of non-viability can be defined that will be appropriate for the application of resolution measures in all circumstances. Whether to apply resolution measures, and the type of measures implemented, will depend upon the factual circumstances of the particular resolution scenario.

Figure 12.1. Stylised relationship between solvency, viability and actions to be taken



12.0.10 A resolution regime should make it possible for any losses to be absorbed by: i) shareholders; ii) general creditors; and iii) policyholders, in a manner that respects the jurisdiction's liquidation claims hierarchy. Policyholders should absorb losses only after all lower ranking creditors have absorbed losses to the full extent of their claims. Mechanisms, such as policyholder protection schemes (PPSs), may mitigate the need for the absorption of losses by policyholders.

12.0.11 Depending on the circumstances, appropriate resolution measures may be applied to one or more separate entities in an insurance group, such as: i) the head of the insurance group; ii) an intermediate holding company below the head of the insurance group; iii) an insurance legal entity within the group; iv) a branch of an insurance legal entity within the group; or v) other regulated (eg banks) or non-regulated entities within the group. For other regulated entities within the group (eg banks), a resolution regime relevant to their sector may apply.

12.0.12 Some insurers operate on a cross-border basis through subsidiaries or branches in another jurisdiction, or through providing insurance services on a cross-border basis without setting up a physical presence outside their home jurisdiction. Also, where an insurance legal entity is a member of a group, there could be intra-group transactions and guarantees among insurance legal entities and/or other group entities in different jurisdictions. Cross-border coordination and cooperation, including exchange of information, is necessary for the orderly and effective resolution of insurers that operate on a cross-border basis.

Voluntary exit from the market

12.1 Legislation provides a framework for voluntary exit from the market that protects the interests of policyholders.

12.1.1 Voluntary exit from the market is initiated by the insurer.

12.1.2 The supervisor should require the insurer which voluntarily exits from the market to make appropriate arrangements for the voluntary exit (eg, run-off or portfolio transfer), including ensuring adequate human and financial resources to fulfil all its insurance obligations.

12.1.3 The supervisor should require the insurer which voluntarily exits from the market through run-off to submit a run-off programme to the supervisor. The programme should include at least the following information:

- expected timeframe;
- projected financial statements;
- human and material resources that will be available;
- governance and risk management of the process;
- communication with policyholders about the insurer's exit from the market; and
- communication to the public.

12.1.4 Insurers that exit from the market on a voluntary basis should continue to be subject to supervision until all insurance obligations are either discharged or transferred to succeeding insurers. Legislation should provide for appropriate requirements for these exiting insurers.

Objectives of the resolution of insurers

12.2 Legislation provides a framework for resolving insurers which:

- **protects policyholders; and**
- **provides for the absorption of losses in a manner that respects the liquidation claims hierarchy.**

12.2.1 The legislation should support the objective of protecting policyholders. This however does not mean that policyholders will be fully protected under all circumstances and does not exclude the possibility that losses be absorbed by policyholders, to the extent they are not covered by PPSs or other mechanisms. A jurisdiction may have additional resolution objectives in the legislation, such as contributing to financial stability.

12.2.2 The legislation should provide a scheme for prioritising the payment of claims of policyholders and other creditors in liquidation (liquidation claims hierarchy). Resolution powers should be exercised in a way that respects the hierarchy of creditors' claims in liquidation. In a resolution action other than a liquidation, creditors should be entitled to compensation if they receive less than they would have received if the insurer was liquidated (ie the "no creditor worse off than in liquidation" (NCWOL) principle). The NCWOL principle may require funding to provide compensation to creditors so that they receive at least as much as they would have received in a liquidation.

12.2.3 Resolution should seek to minimise reliance on public funding. In principle, any public funding used for the resolution of the insurer should be recouped from the insurance sector in a transparent manner. The phrase "reliance on public funding" does not refer to the use of funds from policyholder protection schemes to support the implementation of resolution actions.

CF 12.2.a.1 In addition to the resolution objectives in Standard 12.2, the framework for resolving IAIGs should also include as an objective the contribution to financial stability, where applicable. A jurisdiction may, at its discretion, choose to rank these resolution objectives with respect to IAIGs.

CF 12.2.b The resolution of an IAIG seeks to minimise reliance on public funding.

Planning

12.3 The supervisor and/or the resolution authority requires, as necessary, insurers to evaluate prospectively their specific operations and risks in possible resolution scenarios and to put in place procedures for use during a resolution.

12.3.1 The supervisor may identify risks, specific to an insurer's circumstances, that would arise in resolution and which may impact achieving the resolution objectives of the jurisdiction. For example, such risks may relate to the insurer's provision of relevant information to the supervisor or resolution authority, the continuity of certain business operations, and/or the orderly implementation of a jurisdiction's PPS.

12.3.2 The supervisor should require the insurer to consider such risks and where appropriate, prepare contingency plans to mitigate the risk.

12.3.3 The supervisor should require that the insurer have procedures in place to provide necessary information (eg policyholders' names, types of their contracts, and the value of each contract) to a relevant organisation (such as a PPS) in a timely manner when the insurer enters into resolution.

CF 12.3.a Resolution plans are in place for IAIGs where the group-wide supervisor and/or resolution authority, in consultation with the crisis management group of the IAIG (IAIG CMG), deems necessary.

CF 12.3.a.1 The group-wide supervisor and/or resolution authority should decide, in consultation with members of the IAIG CMG (see ComFrame material under ICP 25), whether a resolution plan is needed for an IAIG, considering at least the following:

- the IAIG's activities and its lines of business;
- the number of jurisdictions where the IAIG operates;
- the complexity of the IAIG's group structure; and
- the potential impact of failure of the IAIG on the financial system and real economy in the jurisdictions in which the IAIG operates.

Other issues that may also be taken into consideration are, for example:

- the IAIG's risk management mechanisms; and
- expected costs, benefits and outcomes of the resolution planning requirement.

CF 12.3.a.2 The group-wide supervisor and/or resolution authority should lead the development of the group-wide resolution plan, in coordination with members of the IAIG CMG, and involve the IAIG as appropriate. To facilitate its implementation, the resolution plan should identify, in particular:

- financial and economic functions that need to be continued to achieve the resolution objectives for the IAIG;
- suitable resolution options to preserve such functions or wind them down in an orderly manner;
- data requirements for the IAIG's business operations, structures and financial and economic functions;
- potential barriers to effective resolution and actions to mitigate those barriers; and
- actions to protect policyholders.

CF 12.3.a.3 Other involved supervisors and/or resolution authorities may deem it appropriate to have their own resolution plan for the IAIG's insurance legal entity in their jurisdictions when, for instance:

- the insurance legal entity's presence in the jurisdiction is large in scope and/or scale;
- the insurance legal entity provides critical and/or non-substitutable insurance coverages; and/or
- its resolution may impact that jurisdiction's financial system and real economy.

Host jurisdiction resolution plans should be established in cooperation with the group-wide supervisor and/or resolution authority to ensure that the plan is as consistent as possible with the group-wide resolution plan for the IAIG.

CF 12.3.a.4 Resolution plans should be reviewed on a regular basis, or when there are material changes to the IAIG's business or structure or any other change that could have a material impact on the resolution plan, and be updated when necessary. These plans should also be subject to regular reviews within the IAIG CMG.

CF 12.3.b Where a resolution plan is required, the group-wide supervisor and/or resolution authority, in coordination with the IAIG CMG:

- **requires relevant legal entities within the IAIG to submit necessary information for the development of resolution plan;**
- **regularly undertakes resolvability assessments to evaluate the feasibility and credibility of resolution strategies, in light of the possible impact of the IAIG's failure on policyholders and the financial system and real economy in the jurisdictions in which the IAIG operates; and**
- **requires the IAIG to take prospective actions to improve its resolvability.**

CF 12.3.b.1 Resolvability assessments should be conducted at the level of those entities where it is expected that resolution actions would be taken, in accordance with the resolution strategies for the IAIG, as set out in the resolution plan.

CF 12.3.b.2 Resolvability assessments should consider if it is feasible and credible for the resolution authority to resolve the IAIG in a way that protects

policyholders and contributes to financial stability while minimising reliance on public funds.

CF 12.3.b.3 Resolvability assessments should be undertaken on a regular basis, or when there are material changes to the IAIG's business or structure, or any other change that could have a material impact on the resolvability assessment. These assessments should also be subject to regular reviews within the IAIG CMG.

CF 12.3.b.4 When the resolution plan and/or resolvability assessment identifies potential barriers to effective resolution, the IAIG may be given the opportunity to propose its own prospective actions to improve its resolvability by mitigating these barriers.

CF 12.3.c The group-wide supervisor and/or resolution authority, in coordination with the IAIG CMG, requires the Head of the IAIG to have and maintain group-wide management information systems (MIS) that are able to produce information on a timely basis, for supervisors and/or resolution authorities, for the purposes of resolution planning and actions.

CF 12.3.c.1 Information should be available at the Head of the IAIG and the legal entity level.

CF 12.3.c.2 The IAIG may rely on its existing information system, so long as it fulfils the objectives of producing information on a timely basis for the purposes of resolution planning and actions.

CF 12.3.c.3 The IAIG should:

- maintain a detailed inventory, including a description and location, of the key MIS used in material legal entities of the IAIG, mapped to core services and critical functions;
- identify and take steps to address legal constraints on the exchange of management information among material entities of the IAIG (for example, as regards the information flow from individual entities of the group to/from the Head of the IAIG);
- demonstrate, as part of the resolution planning process, that it is able to produce the essential information needed to implement plans within an appropriate period of time; and
- maintain specific information at a legal entity level, including, for example, information on intra-group guarantees booked on a back-to-back basis, or information on the assets supporting policyholder liabilities.

Cooperation and coordination

12.4 The roles and responsibilities of relevant authorities within a jurisdiction that are involved in exit of insurers from the market or their resolution are clearly defined.

12.4.1 The jurisdiction should have a designated authority or authorities empowered to exercise powers for the resolution of an insurer. Where

there are multiple authorities within a jurisdiction, their respective mandates, roles and responsibilities are clearly defined and coordinated.

12.4.2 Where different authorities within a single jurisdiction are in charge of the resolution of an insurer, a lead authority that coordinates the resolution of the insurer should be identified.

12.4.3 An example where a lead resolution authority should be identified is where the insurer has insurance and other financial operations (such as banking), and the authority responsible for the resolution of the other financial operations is different from the authority responsible for the resolution of the insurance operations in the jurisdiction.

12.4.4 Coordination agreements may be established where multiple authorities may be involved in the resolution of an insurer.

12.5 The supervisor and/or resolution authority shares information, cooperates and coordinates with other relevant authorities for the exit of insurers from the market or their resolution.

12.5.1 Relevant authorities in this context may include the group-wide supervisor and/or resolution authority, other involved supervisors and/or resolution authorities and others that may need to be involved in the resolution of insurers, such as PPS and supervisors in other financial sectors.

12.5.2 When an insurer voluntarily exits from the market, the supervisor should cooperate and coordinate with other relevant supervisors as necessary.

12.5.3 Cooperation and coordination should include matters, among others, such as consulting with or informing other relevant authorities of eg the anticipated exercise of resolution powers that the resolution authority considers necessary before taking resolution actions, where this is practicable.

12.5.4 When consulting, authorities should seek to determine if coordinated action on the resolution of an insurance group is necessary to avoid or minimise adverse impact on other group entities.

12.5.5 The supervisor and/or resolution authority should seek to achieve a cooperative solution with authorities in other jurisdictions who are concerned with the resolution of the insurance group.

12.5.6 Cooperation and coordination would be crucial when considering resolution action such as ordering the insurer to cease business (for example, when the insurer has overseas branches), freezing the insurer's assets, and/or removing management of overseas branches, subsidiaries, or holding companies.

12.5.7 Information sharing, cooperation and coordination should be undertaken in a manner that do not compromise the prospect of successful exit or resolution.

12.5.8 Cross-border coordination agreements may need to be established between relevant authorities.

Triggers

12.6 Legislation provides criteria for determining the circumstances in which the supervisor and/or resolution authority initiates resolution of an insurer.

12.6.1 Resolution should be initiated where an insurer is no longer viable, or is likely to be no longer viable and has no reasonable prospect of becoming so, even if the entity is solvent in light of financial reporting standards. Criteria that determine or help determine when the supervisor and/or resolution authority initiates resolution should be considered in light of the insurer and the circumstances of its resolution. Criteria for determining whether resolution processes should be initiated may include:

- the insurance legal entity is in breach of the minimum capital requirement (MCR) and there is no reasonable prospect of restoring compliance with MCR;
- the consolidated own funds of the insurance group are lower than the sum of the proportional shares of the MCRs, or minimum capital requirements of the regulated legal entities belonging to the insurance group (eg due to double-gearing);
- the insurer is in breach of other material prudential requirements (such as a requirement on assets backing technical provisions) and there is no reasonable prospect of compliance being restored;
- there is a strong likelihood that policyholders and/or other creditors will not receive payments as they fall due;
- intra-group transactions impede or are likely to impede the ability of the insurer to meet policyholder and/or creditor obligations as they fall due; or
- measures attempting the recovery of the insurer have failed, or there is a strong likelihood that such proposed measures will: i) not be sufficient to return the insurer to viability; or ii) cannot be implemented in a reasonable timeframe.

Powers

12.7 Legislation provides an appropriate range of powers to resolve insurers effectively. These powers are exercised proportionately and with appropriate flexibility.

12.7.1 Powers to resolve insurers should be exercised in a proportionate manner that resolves the insurer most effectively in light of the circumstances and objectives of resolution. Some powers may not be needed for all insurers but only for insurers that are, for example, of systemic importance in the jurisdiction. Some powers may only affect the insurer, while others may impact contractual rights of third parties (such as a suspension of policyholders' rights or restructuring of policies).

12.7.2 Some resolution powers are exercised with the aim to stabilise or restructure an insurer and avoid liquidation. Liquidation can be used in conjunction with other resolution powers. Creditors should have a right to compensation where they do not receive at a minimum what they would have received in a liquidation of the insurer under the applicable insolvency regime (NCWOL principle).

12.7.3 If a court order is required for the resolution authority to exercise resolution powers, the time required for court proceedings should be taken into consideration for the effective implementation of resolution actions.

12.7.4 Powers to resolve insurers that may be exercised, subject to adequate safeguards, should include the following. This list is not exhaustive and the resolution authority should have discretion to apply other available powers. The order of presentation of the powers is not an indication of the sequence in which these powers could be exercised.

- prohibit the payment of dividends to shareholders;
- prohibit the payment of variable remuneration to, and allow the recovery of monies from, Members of the Board, Senior Management, Key Persons in Control Functions and major risk taking staff, including claw-back of variable remuneration;
- prohibit the transfer of the insurer's assets without supervisory approval;
- retain, remove or replace the Board, Senior Management and Key Persons in Control Functions;
- take control of and manage the insurer, or appoint an administrator or manager to do so;
- withdraw the license to write new business and put all or part of the insurance business contracts into run-off;
- sell or transfer the shares of the insurer to a third party;
- restructure, limit or write down liabilities (including insurance liabilities), and allocate losses to creditors and policyholders, where applicable and in a manner consistent with the liquidation claims hierarchy and jurisdiction's legal framework;
- override rights of shareholders of the insurer in resolution, including requirements for approval by shareholders of particular transactions, in order to permit a merger, acquisition, sale of substantial business operations, recapitalisation or other measures to restructure and dispose of the insurer's business or its liabilities and assets;
- terminate, continue or transfer certain types of contracts, including insurance contracts;
- transfer or sell the whole or part of the assets and liabilities of the insurer to a solvent insurer or third party;
- transfer any reinsurance associated with transferred insurance policies without the consent of the reinsurer;
- temporarily restrict or suspend the policyholders' rights of withdrawing their insurance contracts;

- stay rights of the reinsurers of the ceding insurer in resolution to terminate or not reinstate coverage relating to periods after the commencement of resolution;
- impose a temporary suspension of payments to unsecured creditors and a stay on creditor actions to attach assets or otherwise collect money or property from the insurer; and
- initiate the liquidation of the whole or part of the insurer.

12.7.5 The choice and application of the powers set out above should take into account whether an insurer's disorderly failure would potentially cause significant disruption to the financial system and real economy, the types of business the insurer is engaged in, and the nature of its assets and liabilities.

12.7.6 Where the resolution authority takes action which leads to another person taking control of an insurer with a view to restoring, restructuring or running off the business, the resolution authority should continue to be responsible for the orderly resolution of the insurer. In particular, the resolution authority should continue to exercise functions which ensure that the objectives of resolution are met, notwithstanding any additional responsibilities which the person appointed may have to the insurer or to the courts.

12.7.7 Resolution powers should be exercised in a manner that does not discriminate between creditors on the basis of their nationality, the location of their claim, or the jurisdiction where it is payable.

12.7.8 Mechanisms should be in place to (i) enable continuity of cover for policyholders where this is needed and (ii) ensure timely payment of claims to policyholders of the insurer in resolution, with the aim to minimise disruption to the timely provision of benefits to policyholders. A PPS can be one of the mechanisms that can help ensure timely payments to policyholders and minimise disruption.

12.7.9 When requiring contracts to be transferred to another insurer, the resolution authority should satisfy itself that the interests of the policyholders of the transferor and of the transferee are safeguarded. In some cases this may be achieved through varying, reducing or restructuring the transferred liabilities.

12.7.10 Portfolio transfers and transfers of other types of contracts of the insurer in resolution should not require the consent of each policyholder or party to the contract.

12.7.11 Consistent with the liquidation claims hierarchy, insurance liabilities should be written down only after equity and all liabilities that rank lower than insurance liabilities have absorbed losses, and only if the resolution authority is satisfied that policyholders are no worse off than in liquidation after compensation, where necessary.

12.7.12 Information on the period during which policyholders are prohibited from withdrawing from their insurance contracts should be available to policyholders in a transparent manner for the purposes of policyholder protection.

12.7.13 The exercise of stay powers, their scope of application and the duration of the stays should be designed to address the specific situation of the insurer in resolution. For example, the duration of the stay could depend on the type of the insurance or financial contract.

Group and Branch Perspectives

12.7.14 There may be circumstances where resolution powers will need to be exercised at the level of the head of the insurance group and/or non-regulated entities. Resolution authorities should have the capacity to exercise resolution powers directly on such entities within their jurisdiction to the extent necessary and appropriate. Where resolution powers need to be exercised on entities outside of their jurisdiction or legal authority, the resolution authority should cooperate and coordinate with relevant supervisors and resolution authorities in the relevant jurisdictions, to the extent necessary and appropriate.

12.7.15 Unless otherwise specified by the resolution authority, resolution powers exercised on an insurance legal entity (for instance to cease writing business) should also apply to the legal entity's branches. However, the resolution authority responsible for a branch can also exercise powers toward the branch. In either case, the resolution authorities responsible for the branch and the insurance legal entity should consult and cooperate with one another.

12.7.16 The resolution authority may choose which power, or which combination of powers, is applied to which entity within the group. Different types of powers may be applied to different parts of the entity's business.

CF 12.7.a **The powers that the supervisor and/or resolution authority may exercise, subject to adequate safeguards and proportionality, for the resolution of an IAIG include, at least, the following:**

- **prohibit the payment of dividends to shareholders;**
- **prohibit the payment of variable remuneration to, and allow the recovery of monies from, Members of the Boards, Senior Management, Key Persons in Control Functions and major risk taking staff, including claw-back of variable remuneration;**
- **prohibit the transfer of the IAIG's assets without supervisory approval;**
- **retain, remove or replace the Members of the Boards, Senior Management and/or Key Persons in Control Functions;**
- **take control of, and manage, the IAIG, or appoint an administrator or manager to do so;**
- **withdraw the licence to write new business and put all or part of the insurance contracts into run-off;**
- **sell or transfer the shares of the IAIG to a third party;**
- **restructure, limit or write down liabilities (including insurance liabilities), and allocate losses to creditors and policyholders, where applicable and in a manner consistent with the**

liquidation claims hierarchy and jurisdiction's legal framework;

- **override rights of shareholders of the IAIG in resolution, including requirements for approval by shareholders of particular transactions, in order to permit a merger, acquisition, sale of substantial business operations, recapitalisation, or other measures to restructure and dispose of the IAIG's business or its liabilities and assets;**
- **terminate, continue or transfer certain types of contracts, including insurance contracts;**
- **transfer or sell the whole or part of the assets and liabilities of the IAIG to a solvent insurer or third party;**
- **transfer any reinsurance associated with transferred insurance policies without the consent of the reinsurer;**
- **temporarily restrict or suspend the policyholders' rights of withdrawing their insurance contracts;**
- **stay rights of the reinsurers of the ceding insurer in resolution to terminate, or not reinstate, coverage relating to periods after the commencement of resolution;**
- **impose a temporary suspension of payments to unsecured creditors and a stay on creditor actions to attach assets or otherwise collect money or property from the IAIG;**
- **establish a bridge institution;**
- **take steps to provide continuity of essential services and functions including:**
    - **requiring other legal entities within the IAIG (including non-regulated entities) to continue to provide these essential services to the entity in resolution, any successor, or an acquiring entity;**
    - **ensuring that the residual entity in resolution can temporarily provide such services to a successor or an acquiring entity; or**
    - **procuring necessary services from unaffiliated third parties;**
- **temporarily stay early termination rights associated with derivatives and securities financing transactions; and**
- **initiate the liquidation of the whole or part of the IAIG.**

CF 12.7.a.1 In some jurisdictions, PPSs can be utilised as a bridge institution to which insurance contracts of the IAIG are transferred.

CF 12.7.a.2 Essential services mentioned under CF12.7a include, in particular, IT.

Liquidation

12.8 Legislation provides that the supervisor is involved in the initiation of the liquidation of an insurance legal entity (or a branch of a foreign insurer in its jurisdiction).

12.8.1 Legislation should define the involvement of the supervisor in a liquidation, which promotes the protection of policyholders. The supervisor should be authorised to initiate, or should be involved in the liquidation of an insurance legal entity, or a branch of a foreign insurer in its jurisdiction.

12.8.2 In many jurisdictions, all resolution actions, including liquidation, may only be initiated by the supervisor and/or resolution authority. However, in some jurisdictions, the liquidation process can be initiated by another person (such as a creditor of the insurance legal entity, the insurance legal entity itself, or the court). If legislation permits another person to initiate liquidation, it should: i) require prior approval of the supervisor, or ii) at a minimum, require prior coordination with the supervisor. If legislation permits another person to initiate liquidation without such prior approval or coordination, it should provide that the supervisor may challenge the person's action.

12.9 Legislation provides a high legal priority to policyholders' claims within the liquidation claims hierarchy.

12.9.1 Policyholders should receive high legal priority in the liquidation of an insurance legal entity (or of a branch) so that policyholders rank above ordinary unsecured creditors. However, it is common in many jurisdictions that a higher priority is given to a limited number of other categories of claims. These may include claims:

- by liquidators, such as claims corresponding to expenses arising from the liquidation procedure;
- by employees;
- by tax or fiscal authorities;
- by social security systems; and
- claims on assets subject to rights in rem (eg through collateral, lien, mortgage).

12.9.2 In some jurisdictions, policyholders receive higher priority but only on a determined part of the insurance legal entity's assets (eg the assets covering technical provisions). In such jurisdictions, with respect to this portion of the insurer's assets, policyholders' claims are generally subordinate only to liquidation expenses.

12.9.3 Mechanisms facilitating timely payment and, when needed, continuity of contracts should be in place. In some jurisdictions, a PPS or other protection mechanisms can contribute to a resolution and ensure timely payment of claims to policyholders. Where a bridge institution is available, this can ensure continuity of insurance products in cases where no insurer present in the market takes over the insurance portfolio of the insurance legal entity that would otherwise be liquidated. A PPS or other protection mechanisms could also ensure compliance with NCWOL principle by providing compensation to policyholders so that

none are worse off than in liquidation. In some jurisdictions, a PPS can only pay claims after liquidation has been initiated.

Safeguards

12.10 The resolution authority exercises resolution powers in a way that respects the liquidation claims hierarchy and adheres to the NCWOL principle. If the resolution authority departs from the general principle of equal treatment of creditors of the same class (pari passu), the resolution authority substantiates the reasons for such departure to all affected parties.

12.10.1 While respecting the liquidation claims hierarchy, the resolution authority could treat certain types of creditors differently from others in the same class of creditors' hierarchy. In such cases, the reasons for such a treatment should be transparent and clearly explained. Concerned creditors should be protected by the NCWOL principle and where they do not receive at a minimum what they would have received in a liquidation of the entity they should have a right to compensation.

12.10.2 For instance, different types of creditors could be:

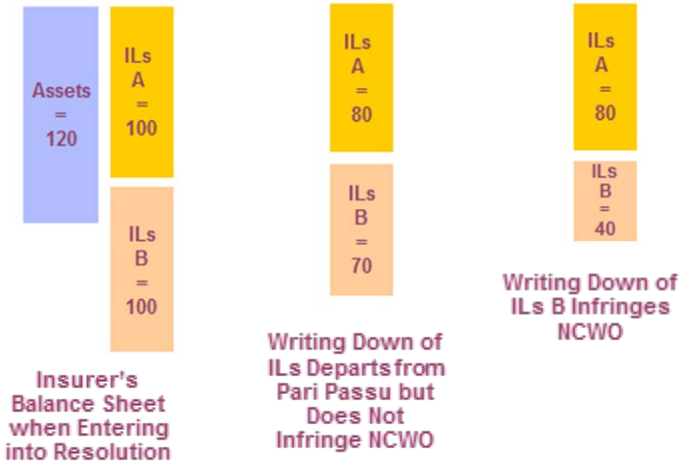
- two categories of policyholders ranking pari passu where one is covered by a PPS while the other is not; or
- two categories of creditors ranking pari passu but the creditors are different in nature (eg direct policyholders versus cedants).

12.10.3 For instance, different treatment of a creditor could be:

- settling contracts ranking pari passu at a different pace; or
- reducing (writing down) contracts ranking pari passu at a different rate.

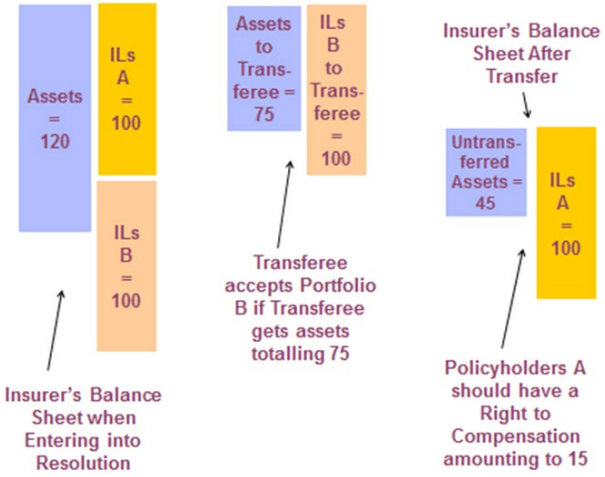
12.10.4 These options could be used provided this does not infringe the NCWOL principle. For instance, Figure 12.2 illustrates the insurance liabilities (ILs) of an insurance legal entity consisting of two portfolios (A and B), where the total assets amount to 120 but the ILs of each portfolio amount to 100. Assuming that these two portfolios rank pari passu, each policyholder would receive 60% of their credit in liquidation. The resolution authority could reduce the ILs of A to 80 and the ILs of B to 70 (for instance, in the event where a sound insurer or sound insurers accepted to fund part of but not the whole shortfall). However, if the resolution authority reduces the ILs of B to 40, the resolution authority will need to provide compensation to policyholders of portfolio B (in the amount of 20) in order to meet the NCWOL principle. This simplified example does not take account of potential PPSs which could pay some claims.

Figure 12.2



12.10.5 The resolution authority could take actions which could worsen the position of some creditors, provided that said creditors receive compensation sufficient to meet the NCWOL principle. Figure 12.3 illustrates this approach – it would be beneficial to policyholders in portfolio B to have their policies transferred, but the portfolio transfer worsens the position of policyholders in portfolio A. Policyholders in portfolio A therefore should receive appropriate compensation to ensure that they are not worse off compared to a liquidation scenario prior to the portfolio transfer. This example does not take account of potential PPSs which could pay some claims.

Figure 12.3



12.11 Legislation provides whether insurance liabilities may be restructured and whether policyholders may absorb losses.

12.11.1 In some jurisdictions, insurance liabilities may be restructured. Restructuring, limiting or writing down insurance liabilities may include:

- suspending or postponing payments to policyholders;

- amending terms of insurance contracts;
- terminating or restructuring options provided to policyholders;
- reducing the value of current and future benefits;
- early settling of contracts by payment of a proportion of the insurance liabilities to provide a more rapid and cost-effective resolution. This can apply to future determined benefits but also, and in particular in the case of inward (accepted) reinsurance, to future contingent claims; or
- restructuring reinsurance contracts to allow losses to be imposed on cedants as appropriate.

12.11.2 In most cases, approval from the court is required for the restructuring, while in some jurisdictions the resolution authority is empowered to restructure all or part of insurance liabilities without court approval. Restructuring should only occur if it adheres to the NCWOL principle.

12.11.3 Where insurance liabilities may be subject to restructuring in resolution, the resolution authority should clearly communicate information (for example, the processes through which such restructuring is undertaken and the extent that policyholders may be forced to absorb losses) to interested stakeholders.

Issues specific to groups and branches

12.12 Where the insurance legal entity belongs to a group and the head of the insurance group is located in the same jurisdiction as the legal entity, mechanisms are in place through which the head of the insurance group is able to be resolved.

12.12.1 When an insurance legal entity is resolved, the resolution of, or the application of some resolution powers to, the head of the group may support or aid the orderly resolution of the insurance legal entity and best ensure the protection of policyholders.

CF 12.12.a.1 ICP 12 and the ComFrame material integrated in ICP 12 may be applicable, where appropriate, to the resolution of:

- the Head of the IAIG, and any intermediate holding company within the IAIG;
- non-regulated operational entities within the IAIG that are significant to the business of the group;
- non-insurance financial institutions within the IAIG; and
- branches of insurers within the IAIG.

This guidance is not intended to override any existing sectoral requirement (eg for banks).

CF 12.12.a.2 Resolution actions should be taken for legal entities and branches within the IAIG, that fall within the scope stipulated above, as necessary and appropriate.

12.13 The resolution authority has the authority to resolve a branch of a foreign insurer located in its jurisdiction and, in such circumstance, coordinates and cooperates with the supervisor and/or resolution authority responsible for the insurance legal entity.

12.13.1 The resolution authority responsible for a branch should have the ability to support a resolution carried out by the resolution authority of the insurance legal entity which owns the branch or by the resolution authority responsible for the resolution of the insurance group to which the branch belongs.

12.13.2 The resolution process may differ in the jurisdiction of the branch and in that of the insurance legal entity, due, among other things, to different insolvency laws and creditor hierarchies.

12.13.3 Where the resolution authority of the insurance legal entity which owns the branch or the resolution authority responsible for the resolution of the insurance group to which the branch belongs are not taking action, or are acting in a manner that does not take sufficient account of the objectives of resolution in the branch jurisdiction, the resolution authority responsible for the branch may need to take actions of its own initiative.

12.13.4 Where the resolution authority for a branch takes resolution action of its own initiative, it should give prior notification and consult the supervisor or resolution authority of the insurance legal entity which owns the branch and/or the supervisor or resolution authority of the insurance.

ICP 13 Reinsurance and Other Forms of Risk Transfer

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 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 least:

- 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 (ie the reinsurance ceded by reinsurers);
- references to ceding insurers should be taken to include ceding reinsurers (ie retrocedents); and
- references to reinsurers should be taken to include retrocessionaires (ie 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 condition 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 condition 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 (ie, 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 Sharing 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 (ie 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 (ie 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 the ICPs, 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 ongoing basis can be particularly helpful.

13.6.8 Key elements of any SPE structure include:

- the insurance risk that it assumes is “fully funded” (ie, 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 (eg 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 (eg 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 (eg by credit rating agencies);
- expertise of the legal advisors involved;
- robustness of any financial or actuarial projections, if applicable (eg 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 least:

- 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 (ie, 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 (eg 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 (eg 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[3] 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.[4] 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.

14.0.6 To achieve consistency with this approach to setting capital requirements in the context of a total balance sheet approach, capital

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

[4] 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.

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 – ie 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, eg 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 (eg 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 (eg 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 eg 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 eg 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 (eg 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 (eg 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 least 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:[5]

[5] 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.

- 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 eg 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 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 (eg 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, eg 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 ie 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, eg 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, ie 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 Investments

The supervisor establishes regulatory investment requirements for solvency purposes in order for insurers to make appropriate investments taking account of the risks they face.

Basis for establishing regulatory investment requirements

15.1 The supervisor establishes regulatory investment requirements on the investment activities of the insurer.

15.1.1 The nature of insurance business 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 interdependence between the insurer's assets and its liabilities are central to an assessment of an insurer's solvency position, and therefore, are important aspects to be addressed by the supervisor and for an insurer to manage.

15.1.2 Quantitative requirements alone are not sufficient to ensure solvency, but should also be complemented with appropriate qualitative requirements on investment risk. Having both kinds of requirements helps to guard against the possibility that the regulatory capital requirements do not fully cover the risks inherent in those investment activities.

15.1.3 Factors to consider in establishing regulatory investment requirements may include:

- the overall quality of risk management practices and corporate governance frameworks of insurers;
- the comprehensiveness and transparency of disclosure frameworks in the jurisdiction and the ability for third parties to exercise sufficient scrutiny and 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; and
- the level of prudence and risk-sensitivity of the regulatory solvency requirements and the risks that they cover.

15.1.4 Additionally, the supervisor should consider requirements applied in other, non-insurance, financial sectors when establishing regulatory investment requirements for insurers. It is important that requirements across financial sectors are as consistent as possible in order to discourage groups from taking advantage of regulatory arbitrage. Consistency of regulation between sectors may assist in maintaining a level playing field and enhancing fairness. However, such requirements should take into account the differences in risk profiles and risk management between sectors.

15.1.5 Openness and transparency of the regulatory investment requirements may help facilitate their effectiveness. The supervisor should be explicit as to the objectives of setting regulatory investment requirements. This is particularly important in order to ensure 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.

Rules-based and principles-based approaches

15.1.6 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, or principles-based, where there is no specific restriction on the asset strategy taken by the insurer, as long as defined principles are met.

15.1.7 Regulatory investment requirements may also be a combination of rules-based and principles-based, setting out some specific rules or restrictions and some principles with which the insurer's investment strategy should comply.

15.1.8 Rules-based requirements may be used to prohibit or limit specific classes of investment. Such rules or restrictions may either be applied directly to the investments or lead to capital charges 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.

15.1.9 Rules-based requirements may be relatively easy to enforce by supervisors, as there is limited scope for different interpretations of the rules. However, rules-based requirements may inhibit innovation in investment strategies and may restrain insurers from holding assets most appropriate for meeting their financial objectives. Rules-based requirements may also discourage insurers from fully developing their own risk management.

15.1.10 Principles-based requirements may provide more flexibility for the insurer to choose particular investments to best manage its investment risks. It may allow the insurer to follow an investment strategy that it believes is the most appropriate to its risk appetite and overall financial objectives. However, it may also be more difficult for the supervisor to determine the need to take supervisory measures as principles-based investment requirements allow some scope for differences in interpretation.

Group perspectives

15.1.11 In addition to meeting the qualitative and quantitative investment requirements at an insurance legal entity level, the insurance group should monitor investment risk exposures on an aggregate basis for the group as a whole.

15.1.12 For insurance groups, regulatory investment requirements may specify how investment exposures should be aggregated for the purposes of determining investment risk at a group level. Such requirements should provide for appropriate mitigation of risks associated with intra-group

transactions, for example, to limit contagion or reputational risk. Issues to be considered may include exposures to related counterparties and other interests over which the insurer has some influence (for example, through a minority interest). In stress situations there will tend to be greater restrictions on movements and realisation of investments across the group. The regulatory investment regime may require contractual evidence of the ability to access assets for solvency purposes before allowing their inclusion for aggregation at the group level.

15.1.13 The regulatory investment requirements that apply at the insurance legal entity and group levels, as well as the objectives of such requirements should be explicit. Such requirements should include issues specific to groups, such as requirements for liquidity, transferability of assets and fungibility of capital within the group.

15.1.14 Regulatory investment requirements should be set having regard to the possibility of losses from investments made by entities of an insurance group weakening another entity or the group as a whole (for example, if there is explicit or implicit support from another entity).

Regulatory investment requirements regarding the asset portfolio

15.2 The supervisor requires the insurer to invest assets so that, for its portfolio as a whole:

- **assets are sufficiently secure and are held in the appropriate location for their availability;**
- **payments to policyholders or creditors can be made as they fall due; and**
- **assets are adequately diversified.**

Security

15.2.1 The insurer's investments should be sufficiently secure for the portfolio as a whole, which is essential in ensuring obligations to policyholders can be met. Regulatory investment requirements may restrict the insurer's selection of, or exposure to, investments that have low security or whose security is difficult to assess reliably. There should be appropriate measures in place to recognise and mitigate aggregations of exposure across the insurer's portfolio, having particular regard to concentrations of low security assets or those whose security is difficult to assess reliably.

15.2.2 The security of an investment is related to the protection of its value and can be affected by credit risk and market risks (including currency risk). The security of an investment is also affected by safekeeping, custodianship or trusteeship. Assets should be held in an appropriate location so they are available to meet policyholder claims where policyholder payments are made.

15.2.3 External credit ratings can assist the insurer in determining the credit risk of an investment. However, the insurer should be aware of the limits of using external credit ratings and conduct its own due diligence to assess credit risk. The supervisor may establish requirements for the appropriate use of external credit ratings. The supervisor may also require the insurer to conduct a credit analysis independent of the

external credit rating, which may help in assessing the security of an investment.

15.2.4 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, such as indirect investments through a collective investment fund or for investments in complex financial instruments such as structured assets. Some markets may also suffer from a lack of transparency or clarity in terms of the applicable regulatory and legal systems and the degree of protection that they provide.

15.2.5 For assets 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, considering the additional risks that are due to the investment structure. For example, additional legal risks may arise if investments are located outside of the insurer's operating jurisdiction(s).

15.2.6 The insurer should evaluate the security of derivative products by taking into account the underlying exposures, as well as the security of the derivative counterparty, the purpose for which the derivative is held, and the cover (such as collateral) the insurer has for derivative exposures. In some cases, derivative counterparties may improve the security by giving the insurer the right to collateral if the counterparty fails. Similarly, the security of investments may be improved by guarantees from third parties.

15.2.7 When engaging in securities lending or repurchase agreements, an insurer should consider counterparty risk and reinvestment risk. The insurer should ensure the transactions are appropriately collateralised (with suitably frequent updating) and should recognise that these transactions do not mitigate the market or credit risk in the security, since the security is returned to the insurer at the end of the transaction. Care should be taken by the insurer when investing the collateral it holds to ensure that the transactions are covered even under adverse market conditions.

Security – group perspectives

15.2.8 The supervisor should consider the possibility that aggregation of exposures in an insurance group may result in heightened security issues which may be less important at the insurance legal entity level. The supervisor should closely monitor a group investing in assets that are not secure, and which could be distributed around the group to avoid investment restrictions.

CF 15.2.a The group-wide supervisor requires the Head of the IAIG to ensure that the IAIG conducts its own due diligence to avoid placing undue reliance on assessments by credit rating agencies with regard to investment selection and risk management process.

CF 15.2.a.1 The IAIG should conduct due diligence to check the appropriateness of credit rating assessments, using various sources of information,

	and should conduct its own credit assessments on its larger or more complex exposures.
CF 15.2.a.2	Undue reliance generally refers to unchallenged acceptance of the ratings provided by credit rating agencies.

Liquidity

15.2.9 The insurer should have assets that generate sufficient cash flows to pay policyholder claims when due, as well as all other obligations. The cash generated from investments includes disposals, maturity, and coupon or dividend payments.

15.2.10 The ability of the insurer to remain liquid may be adversely impacted for a variety of reasons. For example, the insurer:

- pledges or hypothecates its assets;
- experiences an unexpectedly large claim;
- experiences an event resulting in many claims;
- experiences significant shifts in market conditions; or
- has a derivative that needs to be serviced (for example, due to collateralisation or posting of margins).

15.2.11 The ability to realise or liquidate a sufficient amount of investments to meet policyholder claims, as well as all other obligations, at any point in time is important. For example, where an investment is made in a closed fund, a resale is usually not possible. This would 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 an operational disruption.

Liquidity – group perspectives

15.2.12 The insurer and group-wide and other involved supervisors should consider 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 resolution.

15.2.13 Group issues are 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.

15.2.14 Entities within a group frequently engage in intra-group transactions (eg swaps, inter-company loans) in order to manage risks that exist in different parts of the group or to have more mature businesses 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.

15.2.15 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 allowed by the supervisor). The insurers should consider their liquidity needs,

transferability of assets and fungibility of their capital in a stressed environment when determining the minimum criteria for liquidity of their investment portfolio.

CF 15.2.b The group-wide supervisor requires the Head of the IAIG to consider the effect of potential legal and operational impediments to the IAIG's ability to transfer capital and assets on a cross-border basis.

CF 15.2.b.1 The Head of the IAIG should document specific restrictions that apply to the transfer of capital and assets from one jurisdiction to another, and what, if any, additional restrictions apply in the case of the resolution of a legal entity (see ICP 12 Exit from the Market and Resolution). The IAIG should have documented procedures on actions required for cross-border transfer of capital and assets in normal and stressed times.

Diversification

15.2.16 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's overall investment portfolio is adequately diversified and that its asset and counterparty exposures are kept to prudent levels.

15.2.17 There is 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 (eg shares relating to different companies). 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.

15.2.18 With respect to its investment portfolio, the insurer should ensure that it is diversified within and 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. For diversification within a risk category, 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.

15.2.19 To ensure that its investment portfolio is adequately diversified, the insurer should avoid overreliance on, for example, any specific asset type, issuer, counterparty, group, or market and any excessive concentration or accumulation of risk in the portfolio as a whole. The insurer may also consider its asset concentration by type of investment product, by geographical dispersion or by credit rating. Additionally the insurer may consider its aggregate exposure to related entities (such as joint ventures) and different types of exposure to the same entity or group (such as equity investment in a reinsurer which is also providing its reinsurance cover).

Diversification – group perspectives

15.2.20 Having risk management processes to monitor investments on a group-wide basis is more likely to make Senior Management aware of issues (eg asset concentrations) that could be overlooked if only the individual legal entities are monitored. Groups that are unaware of their global exposures could face an inappropriate level of exposure to certain investments, which may create financial difficulties within the group if the value or liquidity of these investments decreases.

Group perspectives

15.2.21 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, particularly due to liquidity concerns. Relatively small holdings in another legal entity, within the same insurance group that does not give the investor control over the issuer 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 issuer, consideration should be given to aggregating the assets of the issuer 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 issuer, ensures the issuer's investment activities are consistent with its own investment policy.

Regulatory investment requirements relating to the nature of the liabilities

15.3 The supervisor requires the insurer to invest in a manner that is appropriate to the nature and duration of its liabilities.

15.3.1 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 needs to use the proceeds of its investments to make payments to policyholders and other creditors when due. The insurer's investment strategies should take into account the extent to which the cash flows from investments match the liability cash flows in terms of timing, amount and currency, 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 insurance policies.

15.3.2 Insurers are not necessarily required to employ an investment strategy which matches the assets and the liabilities as closely as possible. However, to the extent that assets and liabilities are not well matched, movements in financial variables (eg interest rates, market values and exchange rates) may affect the value of the assets and the liabilities differently and result in an adverse economic impact for the insurer.

15.3.3 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. Additionally, the insurer may wish to adopt a mismatched position deliberately in an attempt 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.

15.3.4 Nevertheless, close matching of assets and liabilities is often 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 be possible for the mismatching risk to be covered effectively by capital. Where the supervisor 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.

15.3.5 The insurer should manage conflicts of interest (eg between the insurer's corporate objectives and disclosed insurance policy objectives) to ensure assets are invested appropriately. For example, for with-profits liabilities, an insurer should invest appropriately to meet policyholders' reasonable expectations.

Group Perspectives

15.3.6 Investments that back liabilities including those covering regulatory capital requirements within one of a group's insurance legal entities should be tailored to the characteristics of the liabilities and the needs of the insurance legal entity and not be subject to undue influence from the wider objectives of the group.

Regulatory investment requirements regarding risk assessability

15.4 The supervisor requires the insurer to invest only in assets where it can properly assess and manage the risks.

15.4.1 The insurer should have sufficient information about its investments, including those in collective investment funds, to ensure that its asset risks can be properly managed.

15.4.2 The insurer should understand the risks involved, and determine how material the risk from a proposed investment is, before undertaking any investments. Assessment of risks should take into account the maximum possible loss, including losses that may occur in situations where assets, such as derivatives, become liabilities for the insurer.

15.4.3 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 such a look through is not possible, appropriate techniques should be developed to assess the risks associated with the investment including assessing the investment manager of an investment fund.

15.4.4 Investments that are not traded on a regulated financial market should be kept to prudent levels, as an objective assessment of the risks is likely to be difficult and costly. This is particularly relevant in jurisdictions where standardised approaches to determining regulatory capital requirements are used, since such approaches will often be designed to be not unduly

complex and thus feasible in practice for all insurers. 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.

15.4.5 The insurer should have access to the requisite knowledge and skills to assess and manage the risks of its investments. When an external investment advisor or manager is used, the insurer should retain adequate investment expertise in-house, as it has the ultimate responsibility for its investments.

Group Perspectives

15.4.6 Investments held by entities within a group are sometimes managed centrally by an investment management function, with the entities relying on its expertise. In such arrangements, the investment management function should have the requisite knowledge and skills to assess and manage the risks of these investments and manage the investments with due regard to the needs of individual entities in addition to the group as a whole.

Regulatory investment requirements relating to specific financial instruments

15.5 The supervisor establishes quantitative and qualitative requirements, where appropriate, on:

- **the use of more complex and less transparent classes of assets; and**
- **investments in markets or instruments that are subject to less governance or regulation.**

15.5.1 Complex investments may have a higher risk of large, sudden or unexpected losses due to the nature of the underlying risks and volatilities. Similarly, there are some assets in which investment is permitted by the regulatory investment regime (because the risk is generally sufficiently assessable), but 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, particularly in adverse conditions that 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 the Professional Securities Market of the London Stock Exchange) need to be given special consideration.

15.5.2 The supervisor should therefore establish quantitative or qualitative requirements or restrictions on such investments, as necessary. For example, regulatory investment requirements may include the pre-approval of an insurer's derivative use plan, whereby the insurer has to describe its controls over and testing of the derivative investment process before it is used in a live environment.

15.5.3 The investments described below are examples of investments that may necessitate quantitative and qualitative requirements; however, this is not an exhaustive list and regulatory investment requirements should be flexible and/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

15.5.4 When deciding whether to invest in off-balance sheet structures, the insurer should take into account their unique characteristics and risk exposures. For example, special purpose entities (SPEs) (see ICP 13 Reinsurance and Other Forms of Risk Transfer) are generally more complex than other forms of investments.

15.5.5 An investment strategy that uses an off-balance sheet structure may have an impact on the ability of the insurer to pay policyholder claims and all other obligations, especially under stressed circumstances.

Investments in structured credit products

15.5.6 An insurer may invest in securities or other financial instruments which have been packaged by an SPE and which may originate from other financial institutions (including banks or other 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 (eg 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.

15.5.7 If the supervisor is concerned that the insurer is exposed to an undue level of risk in such cases, it 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 packaged instrument.

15.5.8 In establishing such requirements, the supervisor 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.

15.5.9 Restrictions or prohibitions may be applied to investments in structured products where appropriate conditions are not satisfied.

Use of derivatives and similar commitments

15.5.10 An insurer choosing to engage in derivative activities should clearly define its objectives, ensuring that these are consistent with any supervisory requirements.

15.5.11 When used appropriately, derivatives may 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 should satisfy 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 processes 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.

15.5.12 Given the nature of insurance operations, derivatives should preferably be used as a risk management mechanism rather than for speculation. The supervisor may restrict the use of derivatives (particularly derivatives that involve the possibility of unlimited loss) to the reduction of investment risk or efficient portfolio management. This means that where derivatives are used, it 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 derivative collateral, the tradability of the derivative and, in the case of over-the-counter derivatives, the ability to value and to close out the position when needed. Derivatives should be considered in the context of a prudent overall asset-liability management strategy.

ICP 16 Enterprise Risk Management for Solvency Purposes

The supervisor requires the insurer to establish within its risk management system an enterprise risk management (ERM) framework for solvency purposes to identify, measure, report and manage the insurer's risks in an ongoing and integrated manner.

Introductory Guidance

16.0.1 ERM for solvency purposes is the coordination of risk management, strategic planning, capital adequacy, and financial efficiency in order to enhance sound operation of the insurer and ensure the adequate protection of policyholders. Capital adequacy measures the insurer's assessment of residual risk of its business, after overlaying the mitigating financial effect of the insurer's established risk management system. Any decision affecting risk management, strategic planning or capital would likely necessitate a compensating change in one or both of the other two. Successful implementation of ERM for solvency purposes results in enhanced insight into an insurer's risk profile and solvency position that promotes an insurer's risk culture, earnings stability, sustained profitability, and long-term viability, as well as the insurer's ability to meet obligations to policyholders. Collectively practiced in the industry, ERM for solvency purposes supports the operation and financial condition of the insurance sector. These aspects of ERM should therefore be encouraged from a prudential standpoint.

16.0.2 The ERM framework for solvency purposes (ERM framework) is an integrated set of strategies, policies and processes, established by the insurer for an effective implementation of ERM for solvency purposes.

16.0.3 Components of the ERM framework that are covered in this ICP:

- Risk identification (including group risk and relationship between risks);
- Quantitative techniques to measure risk;
- Inter-relationship of risk appetite, risk limits and capital adequacy;
- Risk appetite statement;
- Asset-liability management, investment, underwriting and liquidity risk management policies;
- Own risk and solvency assessment (ORSA); and
- Recovery planning.

16.0.4 The ERM framework should be integrated within the insurer's risk management system (see ICP 8 Risk Management and Internal Controls).

16.0.5 The ERM framework should enhance an insurer's understanding of material risk types, their characteristics, interdependencies, and the

sources of the risks, as well as their potential aggregated financial impact on the business for a holistic view of risk at enterprise level. Senior Management should exhibit an understanding of the insurer's enterprise risk issues and show a willingness and ability to address those issues. A fundamental aspect of ERM is the development and execution of a consistent, transparent, deliberate, and systematic approach to manage risks, both individually and in aggregate, on an ongoing basis to maintain solvency and operation within the risk appetite and risk limits. ERM should be embedded in an insurer's corporate culture to ensure that the whole organisation contributes to risk awareness, feedback loops and coordinated responses to risk management needs.

16.0.6 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 appetite. Risk limits should be set after careful consideration of strategic objectives, business plans and circumstances and should take into account the projected outcomes of scenarios run using a range of plausible future business assumptions which reflect sufficiently adverse scenarios. A risk limits structure is used to establish guardrails on an insurer's risk profile to optimise its returns without endangering the ability of the insurer to meet its commitments to policyholders.

16.0.7 Some insurers may utilise internal models as part of their ERM process in order to generate sophisticated risk metrics to inform management actions and capital needs. Internal models may enhance risk management and embed risk culture in the insurer. They may provide a common measurement basis across all risks (eg same methodology, time horizon, risk measure, level of confidence) and strengthened risk-based strategic decision-making across the organisation. 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 the capital allocation sufficient to protect the insurer and its policyholders, as well as to improve capital efficiency.

16.0.8 The insurer should have adequate governance and internal controls in place for models used in the ERM framework. The calculation of risk metrics should be transparent, supportable, and repeatable.

16.0.9 An insurer should have contingency plans that describe in advance the necessary actions and resources to limit business disruption and losses resulting from an adverse financial event (such as risk exposures exceeding risk limits), or an operational event (such as a natural disaster). Contingency planning may include a recovery plan, when deemed necessary.

Enterprise risk management framework - risk identification

16.1 The supervisor requires the insurer's ERM framework to provide for the identification of all reasonably foreseeable and relevant material risks and risk interdependencies for risk and capital management.

Risk identification

16.1.1 The scope of risk identification and analysis of risk interdependencies should cover, at least: insurance risk, market risk, credit risk, concentration risk, operational risk and liquidity risk. Other risks may be included, such as conduct risk, legal risk, political risk, reputational risk, strategic risk and group risk.

Sources of risk and the relationship between risks

16.1.2 An insurer should consider the sources 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, control functions and business units. The insurer 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.

16.1.3 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 conditions (such as catastrophe risks and market risks) could be more correlated in a stress situation.

16.1.4 Assessments of risk exposures should consider macroeconomic exposures. For example, an insurer should consider interdependencies between guarantees and options embedded in its products, the assets backing those products, financial markets and the real economy.

16.1.5 Sources of risks may include catastrophes, downgrades from rating agencies or other events that may have an adverse impact on the insurer's financial condition and reputation. These events can result, for example, in an unexpected level of claims, collateral calls or policyholder terminations and may lead to serious liquidity issues. The ERM framework should adequately address the insurer's options for responding to such events.

Group risk

16.1.6 Group risk is the risk that the financial condition of a group or a legal entity within the group may be adversely affected by a group-wide event, an event in a legal entity, or an event external to the group. Such an event may either be financial or non-financial (such as a restructuring).

16.1.7 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 being a legal entity that is part of a group. However, the inter-relationships among legal entities within a group including aspects of control, influence and interdependence alter the impact of risks on the legal entities and should therefore be taken into account in managing the risks of an insurance legal entity within the insurance group and in managing the risks of that insurance group as a whole.

Group perspectives

16.1.8 The ERM framework of an insurance group should address the direct and indirect interrelationships between legal entities within the insurance group. 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 between legal entities within a group may help with the effectiveness of its ERM framework for group-wide solvency assessment purposes. To be effective, the management of insurance group risk should take into account risks arising from all parts of an insurance group, including non-insurance legal entities (regulated or unregulated) and partly-owned entities.

16.1.9 Assumptions that are implicit in the solvency assessment of an insurance legal entity may not apply at an insurance group level because of separation of legal entities within the insurance group. For example, there may be few, if any, constraints on the fungibility of capital and the transferability of assets within an individual insurance legal entity. However, such constraints may feature much more prominently for an insurance group and may restrict the degree to which benefits of diversification of risks across the group can be shared among legal entities within the insurance group. Such constraints should be taken into account in both the insurance group's and the insurance legal entity's ERM frameworks.

CF 16.1.a The group-wide supervisor requires:

- **the group-wide ERM framework to be as consistent as possible across its legal entities; and**
- **material differences in the group-wide ERM framework to be transparent and explicitly linked to legal and supervisory requirements in the jurisdictions where the IAIG operates, and the risks associated with business conducted in those jurisdictions.**

CF 16.1.b The group-wide supervisor requires the group-wide ERM framework to include strategies, policies, and processes to manage effectively at least the following risks and to address these risks in a cross-border context:

- **insurance risk;**
- **market risk;**
- **credit risk;**
- **liquidity risk;**
- **concentration risk;**
- **operational risk;**
- **group risk; and**
- **strategic risk.**

CF 16.1.b.1 While these risks should be recognised and managed in the group-wide ERM framework, each risk category does not have to be

managed separately. Some risk types, such as strategic or concentration risk, may be included in other risk categories.

CF 16.1.c The group-wide supervisor requires the group-wide ERM framework to take into account intra-group transactions (IGT) including:

- **the mechanisms to keep track of intra-group transactions that are of substantial importance to, and have a significant consequence for, the IAIG;**
- **the risks arising from intra-group transactions; and**
- **the qualitative and quantitative restrictions on such risks.**

CF 16.1.c.1 Intra-group transactions may include:

- loans;
- guarantees;
- issuance of contingent capital;
- payment of dividends;
- cost sharing structures;
- service contracts;
- management arrangements and outsourcing;
- reinsurance;
- transactions across different financial services entities within the IAIG; and
- equity holdings.

CF 16.1.c.2 On a consolidated basis, or other aggregated basis, the risks to the IAIG arising from IGT may not be evident. The IAIG's risk assessment of its IGT should consider, among other factors:

- fungibility of capital and transferability of assets (such as capital or equity injections from one legal entity into another);
- currency effects such as if there are cost sharing or service contracts between legal entities located in different jurisdictions;
- correlation or concentration of risk;
- practical issues, including the time needed to reallocate risk and risk mitigants among legal entities; and
- contagion risk within the group.

CF 16.1.c.3 The IAIG should take account of, the risk of support being withdrawn from one part of the IAIG to another due to adverse publicity, poor results, operational inefficiencies, or supervisory measures.

CF 16.1.c.4 The group-wide ERM framework should address any financial or other activities (eg maturity transformation, securities lending) being undertaken by individual legal entities that may change the risk profile

of the group. For example, in securities lending transactions, the group-wide ERM framework may provide that high quality assets not be swapped with low quality assets, that appropriate arrangements for the provisioning of collateral are in place, or that the maturity of the swapped assets does not significantly alter the risk profile of the IAIG.

Enterprise risk management framework – quantitative techniques to measure risk

16.2 The supervisor requires the insurer's ERM framework to:

- **provide for the quantification of risk and risk interdependencies under a sufficiently wide range of techniques for risk and capital management; and**
- **as necessary, include the performance of stress testing to assess the resilience of its total balance sheet against macroeconomic stresses.**

Measuring, analysing and modelling the level of risk

16.2.1 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 insurer should assess regularly the level of risk it bears by using appropriate forward-looking quantitative techniques (such as risk modelling, 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 may also be used in developing long-term business and contingency plans.

16.2.2 Different approaches to measuring risk 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 risks (such as non-life catastrophe), whereas relatively simple calculations may be appropriate in other circumstances.

16.2.3 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, an insurer's ERM framework should take into consideration the distribution of future cash flows to measure the level of risks. The insurer should be careful not to base 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.

Group perspectives

16.2.4 An insurance group should clarify whether data used in risk assessments is based on a consolidated, aggregated or other method. The insurance group should take into account the implications and

inherent risks of the selected methodology when developing its ERM framework. For example, intra-group transactions may be eliminated in consolidation and thus may not be reflected in the consolidated financial statement of the insurance group at the top level. In using the consolidation basis for the ERM framework, the insurance group may be able to account, and take credit, for diversification of risk. Conversely, using another aggregation method may facilitate a more granular recognition of risk.

Use of models for ERM

16.2.5 Measurement of risks undertaken at different valuation dates should be produced on a broadly consistent basis overall, which may make variations in results easier to explain. Such analysis also aids the insurer in prioritising its risk management.

16.2.6 Regardless of how sophisticated they are, models cannot exactly replicate the real world. Risks associated with the use of models (modelling and parameter risk), if not explicitly quantified, should be acknowledged and understood as the insurer implements its ERM framework, including by the insurer's Board and Senior Management.

16.2.7 Models may be external or internal. External models may be used to assess catastrophes or market risks. Internal models may be developed by an insurer to assess specific material risks or to assess its risks overall.

16.2.8 Internal models can play an important role in facilitating the risk management process and the supervisor should encourage insurers to make use of such models for parts or all of their business, where it is appropriate.

16.2.9 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, where permitted.

16.2.10 If used, an internal model may provide an important strategic and operational decision-making tool and should be used to enable the insurer to integrate its risk and capital management processes. In particular, the internal model used for ORSA should be consistent with models for other processes within the ERM framework. These include: assessment of the risks faced within the insurer's business; construction of risk limits structure; and the determination of the economic capital needed, where appropriate, to meet those risks.

16.2.11 To be effective, an internal model should address all the identified risks within its scope, and their interdependencies, and assess their potential impact on the insurer's business given the possible situations that could occur. The methods by which this analysis could be conducted range from simple stress testing of events to more complex stochastic modelling, as appropriate.

16.2.12 The insurer's internal model should be calibrated on the basis of defined modelling criteria that the insurer believes will determine the level of capital appropriate and sufficient to meet its business plan and strategic objectives. These modelling criteria may include the basis for valuation of the assets and liabilities, the confidence level, risk measure and time

horizon, as well as other business objectives (for example, aiming to achieve a certain minimum investment rating).

16.2.13 In constructing its internal model, an insurer should adopt risk modelling techniques and approaches that are appropriate to its risk strategy and business plans. An insurer may consider various inputs to the modelling process, such as economic scenarios, asset portfolios and liabilities from in-force or past business, and regulatory constraints on the transfer of assets.

16.2.14 An internal model used to determine economic capital may enable the insurer to allocate sufficient financial resources to ensure it continues 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 should 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.

16.2.15 If an insurer uses its own internal model as part of its risk and capital management processes, the insurer should validate it and review it on a regular basis. Validation should be carried out by suitably experienced individuals in a different department or persons other than those who created the internal model, in order to facilitate independence. The insurer may wish to consider an external review of its internal model by appropriate specialists; for example, if the internal review cannot be performed with sufficient independence, an external review may be warranted.

16.2.16 Where a risk is not readily quantifiable (for instance some operational risks or where there is an impact on the insurer's reputation), the insurer should make a qualitative assessment that is appropriate to that risk and sufficiently detailed to be useful for risk management. The 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 should inform the insurer's judgments in assessing the size of the risks and enhancing overall risk management.

16.2.17 It may be appropriate for internal models to be used for a group even where the use of an internal model is not an approach appropriate at the insurance legal entity level due to, for example, lack of sufficient data.

CF 16.2.a The group-wide supervisor requires the Head of the IAIG to ensure that the IAIG measures all reasonably foreseeable, quantifiable, and relevant material risks using an economic capital model taking into account the risks that the IAIG faces in different sectors, jurisdictions and economic environments.

CF 16.2.a.1 The IAIG should prioritise its risks in a consistent and reliable manner using appropriate means, including the use of an economic capital model.

CF 16.2.a.2 The economic capital model should be based on techniques that estimate the amount of capital needed in reasonably foreseeable adverse situations to which the IAIG is or may be exposed. The

	economic capital model, in conjunction with other relevant capital measures (for example, regulatory capital requirements), should support major management decisions by focusing attention on capital adequacy.
CF 16.2.a.3	The IAIG should consider the output of its economic capital model and regulatory capital requirements as inputs to its capital planning, which covers at least the IAIG's business planning period.

Stress testing, scenario analysis and reverse stress testing

16.2.18 Stress testing measures the financial impact of stressing one or more factors which could severely affect the insurer. Scenario analysis considers the impact of a combination of circumstances to reflect historical or other 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.

16.2.19 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. For example, these techniques can be used to investigate the effect of proposed management actions.

16.2.20 Scenario analysis may be particularly useful as an aid to communicate risk management issues to the Board, Senior Management, business units and control functions. As such, scenario analysis can facilitate the integration of the insurer's ERM framework within its business operations and establish a sound risk culture.

16.2.21 Reverse stress testing may help identify scenarios that could result in failure or cause the financial position of an insurer to fall below a predefined level. 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 its financial condition and so may be largely qualitative in nature although broad assessment of associated financial impacts may help in deciding the appropriate action to take.

16.2.22 Stress testing is intended to serve the insurer as an aid to sound risk management, including by identifying residual macroeconomic exposure.

16.2.23 Macroeconomic exposure in the insurance sector can accumulate through certain types of insurance liabilities or may be created through non-insurance activities. Examples are:

- savings-oriented products (or protection-oriented products with a savings component) that offer unmatched guarantees on policyholders' premium payments, often combined with embedded options for policyholders;

- products embedding features such as automatic asset sales triggered by asset value decreases or that require dynamic hedging; and
- derivatives contracts such as financial guarantee products including credit default swaps (CDS) that are not used to hedge risk.

16.2.24 In deciding whether it is necessary to require stress testing, and the frequency, scope and type of such stress testing, the supervisor should take into account, for example:

- the nature, scale and complexity of: the insurer, its activities, business model and products, including the characteristics of the guarantees it provides;
- the characteristics of any automatic asset reallocation mechanisms;
- the use of dynamic hedging and the extent to which such guarantees are matched or hedged; and
- its activity in derivatives markets.

Group perspectives

16.2.25 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 group level should consider those that are appropriate and adequate at the insurance legal entity level.

CF 16.2.b The group-wide supervisor requires the IAIG's risk measurement to include:

- **stress and reverse stress testing and scenario analysis the IAIG deems relevant to its risk profile; and**
- **the resilience of its total balance sheet against macroeconomic stresses.**

CF 16.2.b.1 Stresses should include (but may not be limited to) those in the risk transfer markets that may have an adverse effect on the IAIG's risk profile. For example, when developing its scenarios for stress testing, the IAIG should consider reinsurance capacity and related risk transfer costs in future periods after a catastrophic event.

CF 16.2.b.2 The IAIG's assessment of macroeconomic stresses should pay particular attention to the impact of stresses on the value of guarantees and options embedded in insurance products and on the assets backing them.

CF 16.2.c The group-wide supervisor requires the group-wide ERM framework to be independently reviewed at least once every three years, in order to ascertain that it remains fit for purpose.

CF 16.2.c.1	The group-wide ERM framework review may be carried out by an internal or external body as long as the reviewer is independent and not responsible for, nor been actively involved in, the part of the group-wide ERM framework that it reviews.
CF 16.2.c.2	It may be necessary for the IAIG to perform an ad hoc review after a major change has occurred, such as a change in its risk profile, structure or business strategy.

Enterprise risk management framework - Inter-relationship of risk appetite, risk limits and capital adequacy

16.3 The supervisor requires the insurer's ERM framework to reflect the relationship between the insurer's risk appetite, risk limits, regulatory capital requirements, economic capital and the processes and methods for monitoring risk.

16.3.1 An insurer's ERM framework should reflect how its risk management coordinates with strategic planning and its management of capital (regulatory capital requirement and economic capital).

16.3.2 As an integral part of its ERM framework, an insurer should also reflect how its risk management links with corporate objectives, strategy and current circumstances to maintain capital adequacy and solvency and to operate within the risk appetite and risk limits described in the risk appetite statement.

16.3.3 An insurer's ERM framework should use reasonably long time horizon, consistent with the nature of the insurer's risks and the business planning horizon, 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 analysis of these outcomes may help the Board and Senior Management in strategic business planning.

16.3.4 Risks should be monitored and reported to the Board and Senior Management, in a regular and timely manner, so that they are fully aware of the insurer's risk profile and how it is evolving and make effective decisions on risk appetite and capital management.

16.3.5 Where internal models are used for business forecasting, the insurer should perform back-testing, to the extent practicable, to validate the accuracy of the model over time.

16.3.6 The insurer's ERM framework should note the insurer's reinsurance arrangements and how they:

- reflect the insurer's risk limits structure;
- play a role in mitigating risk; and
- impact the insurer's capital requirements.

The use of any non-traditional forms of reinsurance (eg finite reinsurance) should also be addressed.

Enterprise risk management framework - risk appetite statement

16.4 The supervisor requires the insurer to have a risk appetite statement that:

- **articulates the aggregate level and types of risk the insurer is willing to assume within its risk capacity to achieve its financial and strategic objectives, and business plan;**
- **takes into account all relevant and material categories of risk and their interdependencies within the insurer's current and target risk profiles; and**
- **is operationalised in its business strategy and day-to-day operations through a more granular risk limits structure.**

16.4.1 An insurer's risk appetite statement should include qualitative statements as well as quantitative measures expressed relative to earnings, capital, risk measures, liquidity and other relevant measures as appropriate.

16.4.2 Qualitative statements should:

- complement quantitative measures;
- set the overall tone for the insurer's approach to risk taking; and
- articulate clearly the motivations for taking on or avoiding certain types of risks, products, jurisdictional/regional exposures, or other categories.

16.4.3 Risk appetite may not necessarily be expressed in a single document. However the way it is expressed should provide the insurer's Board with a coherent and holistic, yet concise and easily understood, view of the insurer's risk appetite.

16.4.4 The supervisor should require risk capacity of the insurer to include the consideration of regulatory capital requirements, economic capital, liquidity and operational environment.

16.4.5 The risk appetite statement should 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. It should also be communicated across and within the insurer to facilitate entrenching the risk appetite into the insurer's risk culture.

16.4.6 An insurer should consider how to embed these limits in its ongoing operations. This may be achieved by expressing limits in a way that can be measured and monitored as part of ongoing operations. Stress testing may provide an insurer with a tool to help ascertain whether the limits are suitable for its business.

Group perspectives

16.4.7 An insurance legal entity's risk appetite statement should define risk limits taking into account all of the group risks it faces to the extent that they are relevant and material to the insurance legal entity.

16.4.8 When creating a risk limits structure at the insurance legal entity level, the entity's Board and Senior Management should take into account risk limits at the group level.

CF 16.4.a The group-wide supervisor requires the group-wide ERM framework to establish and maintain processes to communicate its risk appetite internally and externally.

CF 16.4.a.1 The granularity of disclosure may differ between internal and external communication.

Asset-liability management, investment, underwriting and liquidity risk management policies

16.5 The supervisor requires the insurer's ERM framework to include an explicit asset-liability management (ALM) policy which specifies the nature, role and extent of ALM activities and their relationship with product development, pricing functions and investment management.

16.5.1 As appropriate, the ALM policy should set out how:

- the investment and liability strategies allow for the interaction between assets and liabilities;
- the liability cash flows will be met by the cash inflows; and
- the economic valuation of assets and liabilities will change under a range of different scenarios.

ALM does not imply that assets should be matched as closely as possible to liabilities, but rather 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 insurer's 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 policy 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 that 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 insurer may not benefit as much from the benefits of scale, hedging, diversification and reinsurance.

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 insurer.

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 likewise, participating business is separated from non-participating. Supervisory requirements or the insurer's ERM framework may require some liabilities to be closely matched with the supporting assets. 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. There may also be gaps in the asset durations available. An ALM policy should address the risks arising from duration or other mismatches (for example, by holding adequate capital or having appropriate risk mitigation in place). The ERM framework should reflect the insurer's capacity to bear ALM risk, according to the insurer's risk appetite and risk limits structure.

Group perspectives

16.5.7 The group-wide ALM policy should take into account any legal restrictions that may apply to the treatment of assets and liabilities within the jurisdictions in which the group operates.

16.6 The supervisor requires the insurer's ERM framework to include an explicit investment policy that:

- **addresses investment risk according to the insurer's risk appetite and risk limits structure;**
- **specifies the nature, role and extent of the insurer's investment activities and how the insurer complies with regulatory investment requirements; and**
- **establishes explicit risk management procedures with regard to more complex and less transparent classes of asset and investments in markets or instruments that are subject to less governance or regulation; and**
- **as necessary, includes a counterparty risk appetite statement.**

16.6.1 An investment policy may 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.

16.6.2 The investment policy should address the safe-keeping of assets including custodial arrangements and the conditions under which investments may be pledged or lent.

16.6.3 Credit risk should be considered in the investment policy.

16.6.4 The investment policy should consider excessive asset concentration based on certain characteristics, including:

- type of asset;
- credit rating;
- issuer/counterparty or related entities of an issuer/counterparty;
- financial market;
- sector; and
- geographic area.

16.6.5 It is important for the insurer to understand the source, type and amount of investment risk. For example, it is important to understand who has the ultimate legal risk or basis risk in a complex chain of transactions. Similar questions arise where the investment is via external funds, especially when such funds are not transparent.

16.6.6 A number of factors may shape the insurer's investment strategy. For insurers in many jurisdictions concentration risk arising from the limited availability of suitable domestic investment vehicles may be an issue. By contrast, international insurers' investment strategies may be complex because of a need to manage or 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.

16.6.7 Where appropriate, the investment policy should outline how the insurer deals with inherently complex financial instruments such as derivatives, hybrid instruments that embed derivatives, private equity, hedge funds, insurance linked instruments and commitments transacted through special purpose entities. Complex or less transparent assets may present operational risks that are difficult to assess reliably, especially in adverse conditions.

16.6.8 An effective investment policy and ERM framework should provide for appropriately robust models reflecting relevant risks of complex investment activities (including underwriting guarantees for such complex securities). There should be explicit procedures to evaluate non-standard risks associated with complex structured products, especially new forms of concentration risk that may not be obvious.

16.6.9 For complex investment strategies, the insurer's investment policy and ERM framework may incorporate the use of stress testing and contingency planning to handle hard-to-model risks such as liquidity and sudden market movements. Trial operation of procedures may also be appropriate in advance of 'live' operation.

16.6.10 The insurer's investment policy and ERM framework should be clear about the purpose of using derivatives and address whether it is appropriate for it to prohibit 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 (ie 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 unregulated over-the-counter derivatives. The effectiveness of clearing facilities available may be a relevant consideration in assessing the counterparty risk associated with some types of over-the-counter derivatives, such as credit default swaps.

16.6.11 A counterparty risk appetite statement sets out the level of risk the insurer is willing to accept that a counterparty will be unable to meet its obligations as they fall due. This may impact the insurer's financial position through, for example, reductions in fair value or impairment of investments, loss of reinsurance cover, open market exposures or the loss of securities that have been loaned.

16.6.12 In deciding whether it is necessary to require a counterparty risk appetite statement, the supervisor should take into account the size of the insurer's counterparty exposures, both in absolute terms and relative to the insurer's portfolio, according to the characteristics outlined in Guidance 16.6.4, as well as the complexity and form of these exposures. Particular attention should be paid to financial sector counterparties, as these counterparties may be more likely to contribute to the build-up of systemic risk. Attention should also be paid to off-balance sheet exposures or commitments, as these may be more likely to materialise during stress.

CF 16.6.a The group-wide supervisor requires the Head of the IAIG to establish and maintain a group-wide investment policy that sets criteria for investment quality and addresses the selection of, and exposure to, low-quality investments or investments whose security is difficult to assess.

CF 16.6.a.1 The group-wide investment policy should take into account the different regulatory investment requirements of the jurisdictions in which the IAIG operates.

CF 16.6.b The group-wide supervisor requires the Head of the IAIG to:

- **set limits, or other requirements, in the group-wide investment policy so that assets are properly diversified and asset concentration risk is mitigated; and**
- **have a counterparty risk appetite statement.**

CF 16.6.b.1 The IAIG should avoid excessive concentrations in any particular:

- type of asset;

- credit rating;
- issuer/counterparty or related entities of an issuer/ counterparty;
- financial market;
- sector; or
- geographic area.

CF 16.6.b.2 To support the assessment of concentrations, the IAIG should analyse aggregate exposures to individual counterparties and to groups of related counterparties both at the legal entity level and group-wide level.

CF 16.6.c The group-wide supervisor requires the Head of the IAIG to establish criteria on intra-group investments in the group-wide investment policy.

CF 16.6.c.1 Criteria on intra-group investments should take into account, when appropriate:

- liquidity;
- contagion or reputational risk;
- valuation uncertainty;
- impact on capital resources;
- nature of the IAIG's business; and
- financial condition of the individual legal entities.

The fact that intragroup investments may be subject to supervisory approval, in certain jurisdictions, does not remove the requirement for the Head of the IAIG to set its own criteria.

CF 16.6.d The group-wide supervisor requires the Head of the IAIG to monitor investments on a group-wide basis to identify levels of investment exposure that do not comply with the group-wide investment policy.

CF 16.6.d.1 Group-wide investment exposures that exceed limits, or any other non-compliance, should be reported to the IAIG Board and Senior Management upon identification. Reports to the IAIG Board and Senior Management should include material exposures that, even if within limits, could create financial difficulties within the IAIG if the value or liquidity of the investments decreases.

16.7 The supervisor requires the insurer's ERM framework to include an underwriting policy that addresses the:

- **insurer's underwriting risk according to the insurer's risk appetite and risk limits structure;**
- **nature of risks to be underwritten, including any material relationship with macroeconomic conditions; and**
- **interaction of the underwriting strategy with the insurer's reinsurance strategy and pricing.**

16.7.1 An underwriting policy should cover the underwriting process, pricing, claims settlement and expense control (where applicable and relevant to the expenses of the underwriting process). Such a policy may include:

- 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 Control of expenses associated with underwriting and payment of claims 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 have systems in place to control their expenses. These expenses should be monitored by the insurer on an ongoing basis.

16.7.3 The underwriting policy should take into account the effectiveness of risk transfer. 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 appetite; and
- the risk will not revert to the insurer in adverse circumstances.

16.7.4 In addressing the nature and amount of risks to be underwritten the underwriting policy should cover, at least:

- product classes the insurer is willing to write;
- relevant exposure limits (eg geographical, counterparty, economic sector); and
- a process for setting underwriting limits.

16.7.5 The underwriting policy should address the potential impact on the insurer's financial position from material correlations between macroeconomic conditions and the insurance portfolio (for example by assessing the potential impact stemming from certain insurance products with embedded guarantees and options).

16.7.6 The underwriting policy should address:

- how an insurer analyses emerging risks in the underwritten portfolio; and
- how emerging risks are considered in modifying underwriting practices.

16.7.7 The underwriting policy should describe interactions with the reinsurance strategy and associated credit risk, and should include details of the reinsurance cover of certain product classes or particular risks.

CF 16.7.a **The group-wide supervisor requires the Head of the IAIG to ensure that the IAIG implements its group-wide ERM framework by establishing procedures and monitoring practices for the use of sufficient, reliable and relevant data for its underwriting, pricing, reserving and reinsurance processes.**

Group-wide claims management policy

CF 16.7.b **The group-wide supervisor requires the Head of the IAIG to establish and maintain a group-wide claims management policy, as part of the group-wide ERM framework, that includes procedures for:**

- **claims estimation and settlement;**
- **feedback into the group-wide underwriting policy and reinsurance strategy; and**
- **claims data reporting for group analysis.**

CF 16.7.b.1 The group-wide claims management policy may establish procedures for:

- delegations of authority for claims settlement;
- criteria for accepting or rejecting claims; and
- escalating claims.

CF 16.7.b.2 A group-wide claims management policy should allow insurance legal entities to establish individual claims management policies and processes, adjusted to supervisory requirements and circumstances in their jurisdictions.

CF 16.7.b.3 Escalating claims may include information about sudden increases in claim activity, delays in settlements and increased rejections.

Group-wide strategy for reinsurance and other forms of risk transfer

CF 16.7.c **The group-wide supervisor requires the Head of the IAIG to establish and maintain a group-wide strategy for reinsurance and other forms of risk transfer as part of the group-wide ERM framework that considers the following issues, as applicable:**

- **the 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;**
- **use of alternative risk transfer, including capital markets risk transfer products; and**
- **effectiveness of risk transfer in adverse circumstances.**

CF 16.7.c.1 A strategy for other forms of risk transfer may include the use of capital markets risk transfer products (for example, insurance linked securities). Strategic considerations may include factors like the maturity of the capital markets offering such risk transfer products, regulatory approaches regarding the use of such risk transfer products, and overall mix of traditional reinsurance with other forms of risk transfer.

Group-wide actuarial policy

CF 16.7.d The group-wide supervisor requires the Head of the IAIG to establish and maintain a group-wide actuarial policy, as part of the group-wide ERM framework, that consists of a set of group-wide practice standards, covering at least:

- **the process to assess the appropriateness, at the group-wide level, of the data, methodologies and underlying models used, as well as the assumptions made in the calculation of technical provisions;**
- **the process to calculate reinsurance recoverable assets taking into account the design of the reinsurance programme under the reinsurance strategy of the IAIG; and**
- **model risk management of internal models that generate actuarial and financial projections for solvency purposes.**

CF 16.7.d.1 The group-wide practice standards comprising the group-wide actuarial policy should:

- be compliant with applicable laws and regulations, accounting regime, and professional actuarial standards;
- formalise materiality thresholds to trigger higher levels of management actions to ensure well-governed activities;
- provide for a data validation process that supports actuarial activities to ensure data quality, comprehensiveness, granularity and timeliness;
- provide a framework for determining assumptions used in valuations, including a process of incorporating the experience of the IAIG and its insurance legal entities, as well as a process of developing assumptions if the IAIG does not have enough experience in a particular business line or market;
- articulate model validation and maintenance procedure to ensure that model usage and model modifications align with the risk appetite and risk limits structure; and

- create consistent management information requirements from in-depth reviews and monitoring of actuarial activities.

CF 16.7.d.2 The group-wide actuarial policy should contain practice standards to raise awareness of matters that have, or are likely to have, a materially adverse effect on the solvency, reserves or financial condition of one of the insurance legal entities, or the IAIG as a whole. Such standards would prompt the group-wide actuarial function to inform the relevant Board, Senior Management or Key Persons in Control Functions, as appropriate, for suitable action (see ICP 8 Risk Management and Internal Controls).

CF 16.7.d.3 Differences in reporting may exist at the insurance legal entity level to comply with jurisdictional requirements. The group-wide actuarial policy should focus on group-wide reporting requirements, both for internal management purposes and for reporting and disclosure purposes. The group-wide reporting should reflect jurisdictional differences.

CF 16.7.d.4 The group-wide actuarial policy should require an assessment of the consistency of the base assumptions used to derive technical provisions compared to those used to derive capital requirements, economic capital models, or the forward-looking view in the ORSA. Such an assessment of consistency may provide insight as to the coherence of the base assumptions and those applied in stress conditions.

CF 16.7.e The group-wide supervisor requires the group-wide actuarial function, as part of the group-wide ERM framework, to report (whether certified or not) to the IAIG Board annually on at least the following:

- **a prospective actuarial analysis of the financial condition of the IAIG which goes beyond the current balance sheet of the IAIG;**
- **the reliability and sufficiency of the technical provisions;**
- **the adequacy of reinsurance credit for technical provisions; and**
- **consideration of non-insurance legal entities and non-regulated legal entities.**

CF 16.7.e.1 The group-wide actuarial function should provide the IAIG Board an actuarial analysis of the current and future financial condition of the IAIG given recent experience and the group-wide policies for underwriting, claims management and investment and the group-wide reinsurance strategy.

CF 16.7.e.2 The group-wide actuarial function may use the underlying actuarial reports submitted by the individual insurance legal entities as input to its annual reporting to the IAIG Board. Further examples of issues that could be addressed include:

- the assumptions used by all of the insurance legal entities in the group and the consolidation/aggregation method applied at the group level;
- the methodologies used to determine current estimates by each insurance legal entity and the consolidation/ aggregation method applied at the group level;
- the methodologies used to determine the margin over current estimate by each insurance legal entity and the consolidation/aggregation method applied at the group level;
- the availability and appropriateness of data used in valuations;
- back-testing of assumptions and valuations;
- uncertainty in current estimates used by both insurance legal entities and at the consolidated/aggregated group level;
- the adequacy of pricing, taking into account the underwriting policies, at the appropriate unit level, the insurance legal entity level and the group level;
- the performance of the IAIG's insurance portfolios and analysis of any changes in business volumes, exposures, claims experience, mix of business and pricing during the year;
- asset-liability management under the group-wide investment policy;
- suitability and adequacy of reinsurance or other forms of risk transfer arrangements, taking into account the strategies for underwriting and claims management, as well as the overall financial condition and risk appetite of the IAIG; and
- the extent of reliance on the values provided by non-insurance legal entities.

16.8 The supervisor requires the insurer's ERM framework to address liquidity risk and to contain strategies, policies and processes to maintain adequate liquidity to meet its liabilities as they fall due in normal and stressed conditions.

16.8.1 When analysing its liquidity profile, the insurer should assess the liquidity of both its assets and liabilities. The insurer should consider, where applicable, issues such as:

- market liquidity in normal and stressed conditions, quality of assets and its ability to monetise assets in each situation;
- characteristics of insurance contracts that may affect policyholder behaviour around lapse, withdrawal or renewal;

- adverse insurance events that may trigger short-term liquidity needs, including catastrophes;
- non-insurance activities such as margining or posting collateral for derivatives contracts, securities lending or repurchase agreements; and
- contingent sources of liquidity (including committed lines of credit or future premium income) and whether these would be available in stressed conditions.

16.8.2 An insurer should have well-defined processes and metrics in place, which may be simple or more advanced depending on its activities, to assess its liquidity position at different time horizons on a regular basis. An insurer's liquidity analysis should cover both normal and stressed market conditions. The insurer should assess the results of such analysis in light of its risk appetite.

16.8.3 Upon the supervisor's request, the insurer should report its liquidity risk management processes and analysis, including key assumptions or metrics.

Group perspectives

16.8.4 An insurance group's assessment should result in a coherent view of liquidity risk across legal entities within the group. For example, where an individual legal entity relies on the head of the group for funding, this should be accounted for in both the individual legal entity's and the head of the group's liquidity analysis.

16.8.5 When analysing its liquidity position, an insurance group may use different scenarios and analyses on a legal entity level and group-wide level where appropriate. Such scenarios should take into account that circumstances may differ between individual legal entities and the group as a whole.

16.9 The supervisor requires, as necessary, the insurer to establish more detailed liquidity risk management processes, as part of its ERM framework, that include:

- **liquidity stress testing;**
- **maintenance of a portfolio of unencumbered highly liquid assets in appropriate locations;**
- **a contingency funding plan; and**
- **the submission of a liquidity risk management report to the supervisor.**

16.9.1 Liquidity risk increases as the imbalance between liquidity sources and needs grows, for instance due to liquidity transformation. Unexpected liquidity needs could be generated by, for example:

- derivatives, particularly any collateral or margin that needs to be posted for mark-to-market declines in the value of the contract;
- securities financing transactions, including repurchase agreements and securities lending;

- insurance products that contain provisions that allow a policyholder to withdraw cash from the policy with little notice or penalty; and
- insurance products covering natural catastrophes.

These activities may contribute to systemic risk when not properly managed, for instance when funds received from short-term securities lending or repurchase agreements or balances from more liquid insurance products are invested in illiquid assets.

16.9.2 Some insurers are required to establish more detailed liquidity risk management processes as compared to those processes set out in Standard 16.8. More detailed liquidity risk management processes are intended to help the insurer with its risk management. Additionally, the measures may provide the supervisor with a view on vulnerabilities that may cause funding shortfalls in stress.

16.9.3 Liquidity stress testing is a forward looking risk management tool to reveal vulnerabilities in the insurer's liquidity profile and provide information on its ability to meet liabilities as they fall due. A portfolio of unencumbered highly liquid assets may provide a source of liquidity for the insurer to meet its liabilities as they fall due. A contingency funding plan, describing the strategies for addressing liquidity shortfalls in stress situations, may assist the insurer in addressing an unforeseen stress situation, where its liquid assets are insufficient or unexpectedly become illiquid. A liquidity management report could assist the insurer and the supervisor to address shortcomings in the insurer's risk management by laying out details of its liquidity risk management in an accessible format.

16.9.4 In deciding whether it is necessary to require more detailed liquidity risk management processes, and the intensity of such processes, the supervisor should take into account the nature, scale and complexity of the insurer's activities that lead to increased liquidity risk exposure as well as the risk amplification effects related to the size of the insurer. Increased liquidity risk exposure may depend on, for example, the magnitude of potential collateral or margin calls from derivatives or other transactions, the use of securities financing transactions or the characteristics of insurance contracts that may affect policyholder behaviour around lapse, withdrawal or renewal.

16.9.5 The supervisor may increase or decrease the intensity of these requirements by, for example, varying the frequency, scope and granularity of liquidity stress testing, the proportion of various types of highly liquid assets allowed in the portfolio or the form and level of detail in the contingency funding plan and liquidity risk management report.

16.9.6 Where an insurer is required to establish more detailed liquidity risk management processes, the supervisor should assess the effectiveness of their implementation, including the interaction with existing control mechanisms. Additionally, the supervisor should evaluate the quality and quantity of the assets that the insurer includes in its portfolio of highly liquid assets in light of the liquidity characteristics of its activities. The supervisor may develop its own, general, criteria for highly liquid assets.

CF 16.9.a The group-wide supervisor requires the Head of the IAIG to assess the IAIG's resilience against severe but plausible liquidity stresses to determine whether current exposures are within the IAIG's liquidity risk appetite.

CF 16.9.a.1 Forward-looking risk assessments should be done through scenario analysis or stress testing to reveal vulnerabilities in an IAIG's liquidity profile and should be performed for material legal entities and the IAIG as a whole.

CF 16.9.a.2 Depending on its business model, an IAIG may be vulnerable to different liquidity stresses than other insurers. Certain activities may contribute to larger or less predictable liquidity needs. The group-wide supervisor should therefore consider the nature, scale, and complexity of the IAIG's activities that lead to increased liquidity risk exposure as well as the risk amplification effects related to the size of the IAIG when setting its expectations of the IAIG's stress testing. The group-wide supervisor may, based on these considerations, vary the frequency, scope and granularity of liquidity stress testing.

CF 16.9.a.3 The group-wide supervisor may suggest the IAIG include in its assessment certain stresses that have been informed by the group-wide supervisor's macroprudential surveillance (ICP 24 Macroprudential Supervision).

CF 16.9.a.4 The IAIG may consider the following when designing severe but plausible stresses:

- exposure to insurable events;
- withdrawals from, and run-offs of, insurance policies;
- contingent off-balance sheet exposures;
- the impact of a deterioration in the IAIG's credit rating;
- the ability to transfer liquidity between legal entities and between jurisdictions;
- currency convertibility and access to foreign exchange markets;
- reductions in the ability to access secured and unsecured wholesale funding; and
- the correlation and concentration of funding sources.

CF 16.9.a.5 The IAIG may consider the impact of chosen stresses on the appropriateness of its assumptions relating to:

- correlations between funding markets;
- the effectiveness of diversification across its chosen sources of funding;
- additional margin calls and collateral requirements;
- reliance on committed lines of credit;

- estimates of future balance sheet growth and premium income;
- the continued availability of market liquidity, including in currently highly liquid markets;
- ability to access secured and unsecured funding; and
- currency convertibility.

CF 16.9.a.6 The IAIG should evaluate its cash inflows (sources) and cash outflows (needs) under stress scenarios and determine its stressed liquidity position, ie its net stressed cash outflows.

CF 16.9.b The group-wide supervisor requires the Head of the IAIG to establish and maintain an adequate level of unencumbered highly liquid assets in appropriate locations.

CF 16.9.b.1 The IAIG should maintain adequate liquidity to meet its liabilities as they fall due in normal and stressed conditions. Where stress scenarios reveal stressed cash outflows that exceed stressed cash inflows, the IAIG should hold unencumbered highly liquid assets, with appropriate haircuts, of sufficient value to meet excess stressed cash outflows.

CF 16.9.b.2 The group-wide supervisor should consider the results of the IAIG's stress testing or scenario analysis when assessing the quality and quantity of the assets that the IAIG considers to be highly liquid assets. Where an IAIG is subject to significant short-term liquidity needs (for example daily or weekly) the supervisor may require higher quality assets than an IAIG subject to longer-term needs. The group-wide supervisor may also require an IAIG with larger or less predictable stressed liquidity needs to hold a larger amount of highly liquid assets than an IAIG with smaller and more consistent liquidity needs.

CF 16.9.b.3 The IAIG should be able to demonstrate to the group-wide supervisor the liquidity of any assets it considers highly liquid assets in its liquidity risk management report.

CF 16.9.b.4 To promote their usability, assets that the IAIG relies on for liquidity should be free of legal, regulatory, contractual or other restrictions on the ability of the IAIG to liquidate, sell, transfer, or assign the assets (ie unencumbered).

CF 16.9.b.5 The Head of the IAIG should ensure that its portfolio of highly liquid assets is sufficiently diversified. This may include looking through to the underlying assets to determine the extent of concentration risk. The Head of the IAIG should also consider whether it holds a substantial share of the market for a particular instrument, counterparty or asset class to assess if the market would be able to bear the IAIG's sales and whether market reaction would not adversely impact the IAIG's ability to monetise its assets as planned.

CF 16.9.b.6 The Head of the IAIG should consider the marketability and realisability, including as acceptable collateral, of its highly liquid assets by taking into account factors such as market depth and access, monetisation timelines (for example delays in finding a willing buyer, time to settlement) and the likelihood and extent of forced-sale

losses. In stressed market conditions, it may not be feasible to value properly or sell some types of assets or to do so without a significant loss in value.

CF 16.9.b.7 Liquidity is not always freely transferable within a group when needed. The Head of the IAIG should ensure that liquidity is available to legal entities within the group when needed, subject to any applicable legal, regulatory or operational constraints, including cross-border constraints.

CF 16.9.b.8 The minimum criteria for determining asset liquidity may be addressed in the group-wide investment policy or a separate liquidity policy.

CF 16.9.c The group-wide supervisor requires the Head of the IAIG to maintain a contingency funding plan to respond to liquidity stress events.

CF 16.9.c.1 The group-wide supervisor should consider the nature, scale, and complexity of the IAIG's activities that lead to increased liquidity risk exposure, as well as the risk amplification effects related to the size of the IAIG, when setting its expectations of the IAIG's contingency funding plan requirements. This includes the form and level of detail of the contingency funding plan and the frequency for reviewing and updating the plan. The group-wide supervisor's expectations may be informed by the IAIG's liquidity stress testing or scenario analysis, which may reveal funding sources most likely to be impacted during stress and those on which the IAIG is most reliant. The group-wide supervisor may consider requiring a more detailed or frequently updated plan from an IAIG with more unpredictable cash inflows and outflows or where cash inflows and outflows are more significantly impacted by the IAIG's liquidity stress tests or scenario analysis.

CF 16.9.c.2 A contingency funding plan describes the strategies for addressing liquidity shortfalls in stress situations, including the methods that the IAIG would use to access alternative sources of funding.

CF 16.9.c.3 A contingency funding plan should include quantitative metrics that the IAIG would use to identify a liquidity stress event, including the level and nature of the effect it would have on the IAIG's liquidity position and on sources of available funding.

CF 16.9.c.4 A contingency funding plan should outline the strategies, policies and processes to manage a range of stresses. The plan should establish a clear allocation of roles and clear lines of management responsibility. The plan should define procedures for identifying early warning indicators for potential liquidity stress events that are based on the features of the IAIG's business.

CF 16.9.c.5 The supervisor may allow the IAIG's contingency funding plan to be developed as part of a recovery plan.

CF 16.9.d The group-wide supervisor requires the Head of the IAIG to report, at least annually, on its management of liquidity risk. The report includes at least the following:

- **a liquidity risk appetite statement;**
- **established liquidity risk limits;**

- **a discussion of the current liquidity position of the IAIG in relation to its liquidity risk appetite and limits;**
- **a summary of strategies, policies and processes that the IAIG has in place to manage liquidity risk;**
- **a discussion of potential vulnerabilities in the IAIG's liabilities as well as the means of enhancing the liquidity position; and**
- **the IAIG's approach to, and results of, liquidity stress testing.**

CF 16.9.d.1 The group-wide supervisor should consider the nature, scale, and complexity of the IAIG's activities that lead to increased liquidity risk exposure as well as the risk amplification effects related to the size of the IAIG when setting liquidity reporting requirements, including the level of detail of the report and the frequency for reviewing and updating the report. The supervisor may determine that the reporting requirement is satisfied by reference to other risk management policies, risk reporting and/or the ORSA report.

CF 16.9.d.2 The summary of strategies, policies and processes should discuss any metrics the IAIG uses to identify, measure, monitor, and control liquidity risk as well as how the results from the liquidity stress testing are incorporated into day-to-day management of the IAIG. The Head of the IAIG should have a process in place to discuss the results and take the necessary actions.

Own risk and solvency assessment (ORSA)

16.10 The supervisor requires the insurer to perform regularly its own risk and solvency assessment (ORSA) to assess the adequacy of its risk management and current, and likely future, solvency position.

16.10.1 The insurer should document the main outcomes, rationale, calculations and action plans arising from its ORSA.

16.10.2 ORSAs should be largely driven by how an insurer is structured and how it manages itself. The performance of an ORSA at the insurance legal entity level does not exempt the group from conducting a group-wide ORSA.

16.11 The supervisor requires the insurer's Board and Senior Management to be responsible for the ORSA.

16.11.1 The Board should adopt a rigorous process for setting, approving, and overseeing the effective implementation by Senior Management of the insurer's ORSA.

16.11.2 Where appropriate, the effectiveness of the ORSA should be validated through internal or external independent overall review by a suitably experienced individual.

16.12 The supervisor requires the insurer's ORSA to:

- **encompass all reasonably foreseeable and relevant material risks including, at least, insurance, credit, market, concentration, operational and liquidity risks and (if applicable) group risk; and**

- **identify the relationship between risk management and the level and quality of financial resources needed and available;**

and, as necessary:

- **assess the insurer's resilience against severe but plausible macroeconomic stresses through scenario analysis or stress testing; and**
- **assess aggregate counterparty exposures and analyse the effect of stress events on material counterparty exposures through scenario analysis or stress testing.**

16.12.1 The insurer should consider in its ORSA 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. The 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 sources 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.

16.12.2 The ORSA should explicitly state which risks are quantifiable and which are non-quantifiable.

16.12.3 In deciding whether it is necessary to require scenario analysis or stress testing as part of the ORSA, and the frequency, scope and type of such scenario analysis or stress testing, the supervisor should take into account, for example, the nature, scale and complexity of the insurer, its business model and products and the size of the insurer's exposures, both in absolute terms and relative to the insurer's portfolio. For macroeconomic exposure, relevant factors may include the characteristics of the guarantees the insurer provides and the extent to which such guarantees are matched or hedged, the characteristics of any (automatic) asset reallocation mechanisms, the use of dynamic hedging, the insurer's activity in derivatives markets or other drivers of volatility in the sources or uses of cash. For counterparty exposure, particular attention should be paid to financial sector counterparties, as these may be more likely to contribute to the build-up of systemic risk, and to off-balance sheet exposures or commitments, as these may be more likely to have an impact during stress.

Group perspectives

16.12.4 An insurance group's ORSA should:

- include all reasonably foreseeable and relevant material risks arising from every legal entity within the insurance group and from the widest group of which the insurance group is part;
- take into account the fungibility of capital and the transferability of assets within the group; and

- ensure capital is not double counted.

16.12.5 Similarly, an insurance legal entity's ORSA should include all additional risks arising from the widest group to the extent that they impact the insurance legal entity.

16.12.6 In 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 insurance legal entities.

16.12.7 Given the level of complexity at insurance group level compared with that at an insurance legal entity level, additional analysis and information is likely to be needed for the group's ORSA in order to address comprehensively the range of insurance group level risks. For example, it may be appropriate to apply a contagion test by using stress testing to assess the impact of difficulties in each legal entity within the insurance group on the other insurance group entities.

16.12.8 In conducting its group-wide ORSA, the group should be able to account for diversification in the group. Moreover, the group should be able to demonstrate how much of the diversification benefit would be maintained in a stress situation.

CF 16.12.a The group-wide supervisor requires the Head of the IAIG to perform a group-wide ORSA, using both quantitative and qualitative approaches, which takes into account at least:

- **the legal and management structures of the group;**
- **group-wide economic capital models;**
- **risk aggregation;**
- **the fungibility of capital and the transferability of assets within the group; and**
- **the outputs of the economic capital model and the regulatory capital requirements.**

CF 16.12.a.1 In conducting its group-wide ORSA, the IAIG should consider all material risks arising from its legal entities including non-regulated ones. In particular, political and reputational risks should be considered.

CF 16.12.b The group-wide supervisor requires the Head of the IAIG, as part of the group-wide ORSA, to:

- **assess the IAIG's resilience against severe but plausible macroeconomic stresses through scenario analysis or stress testing; and**

- **assess aggregate counterparty exposures and analyse the effect of stress events on material counterparty exposures through scenario analysis or stress testing.**

CF 16.12.b.1 Scenario analysis of material counterparty exposures should assess the potential impact on the IAIG's financial position of the deterioration of the credit-worthiness or of the default of individual legal entities, sectors or geographic areas.

ORSA - economic and regulatory capital

16.13 The supervisor requires the insurer to:

- **determine, as part of its ORSA, the overall financial resources it needs to manage its business given its risk appetite and business plans;**
- **base its risk management actions on consideration of its economic capital, regulatory capital requirements, financial resources, and its ORSA; and**
- **assess the quality and adequacy of its capital resources to meet regulatory capital requirements and any additional capital needs.**

16.13.1 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 appetite, risk limits structure and business plans, based on an assessment of its risks, the relationship between them and the risk mitigation in place. Determining economic capital may help 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.

16.13.2 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.

16.13.3 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.

Re-capitalisation

16.13.4 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 an ongoing 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.

16.13.5 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 conduct of business 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.

16.13.6 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, the supervisor 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.

Group perspectives

16.13.7 An insurance group should determine, as part of its ORSA, the overall financial resources it needs to manage its business given its risk appetite and business plans and demonstrate that its supervisory requirements are met. The insurance group's risk management actions should be based on appropriate risk limits and consideration of its economic capital, regulatory capital requirements and financial resources. Economic capital should thus be determined by the insurance group as well as its insurance legal entities, and appropriate risk limits and management actions should be identified for both the insurance group and the insurance legal entities.

16.13.8 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.

ORSA - continuity analysis

16.14 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; and**
- **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.**

Capital planning and forward-looking perspectives

16.14.1 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 market and economic conditions, innovations in the industry and other factors such as demographic, legal and regulatory, medical and social developments.

16.14.2 Where appropriate, the supervisor 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.

16.14.3 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 (eg where business would become unviable or the market would lose confidence in it) and the actions necessary to manage this risk.

16.14.4 As a result of continuity analysis, the supervisor should encourage insurers to maintain contingency plans and procedures. 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.

Projections

16.14.5 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. The insurer's continuity analysis should help to ensure sound, effective and complete risk management processes, strategies and systems. It should also help 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 the insurer is or may be exposed to 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.

16.14.6 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. 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 meaningful, the insurer should also consider changes in external factors such as possible future events including changes in the political or economic situation.

Link with business strategy

16.14.7 Through the use of continuity analysis an insurer should be better able to link its current financial position with future business plan projections and ensure its ability to maintain its financial condition in the future. This may help the insurer to further embed its ERM framework into its ongoing and future operations.

16.14.8 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 to reduce its capital requirement through diversification 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 may enable the insurer to change its capital exposure as part of its long-term strategic decision making.

16.14.9 As a result of such strategic changes, the risk profile of an insurer may alter, so that different risks should 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 provide the link between these two processes.

Group perspectives

16.14.10 An insurance group should 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 legal entities to continue in business.

16.14.11 An insurance legal entity's continuity analysis should assess 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. The insurance legal entity and the insurance group should both take into account the business risks

they face including the potential impact of changes in the economic, political and regulatory environment.

16.14.12 In their continuity analysis, insurance groups should pay particular attention to whether the insurance group will have available cash flows (eg from surpluses released from long-term funds or dividends from other subsidiaries) and whether they will be transferable among legal entities within the group 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 in stressed conditions (eg reducing new business or cutting dividends).

16.14.13 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 re-capitalisation (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 may need to be taken (eg intra-group movements of resources, other intra-group transactions or group restructuring).

16.14.14 The insurance group should also apply reverse stress testing to identify scenarios that could result in failure or cause the financial position of the insurance group to fall below a predefined level and the actions necessary to manage this risk.

Recovery Planning

16.15 The supervisor requires, as necessary, insurers to evaluate in advance their specific risks and options in possible recovery scenarios.

16.15.1 The supervisor may require an insurer to produce a recovery plan that identifies in advance options to restore the financial position and viability if the insurer comes under severe stress (see Application Paper on Recovery Planning). In deciding whether it is necessary to require a recovery plan, and the form, content and level of detail of such recovery planning, the supervisor should take into account, for example, the insurer's complexity, systemic importance, risk profile and business model. A recovery plan is intended to serve the insurer as an aid to sound risk management. Additionally, if the insurer comes under severe stress, a plan may serve the supervisor as valuable input to any necessary supervisory measures.

16.15.2 The supervisor should require the insurer to provide the necessary information to enable the supervisor to assess the robustness and credibility of any recovery plan required. If the supervisor identifies material deficiencies in the plan, it should provide feedback and require the insurer to address these deficiencies.

16.15.3 The supervisor should require the insurer to review any recovery plan required on a regular basis, or when there are material changes to the insurer's business, risk profile or structure, or any other change that

could have a material impact on the recovery plan, and to update it when necessary.

CF 16.15.a The group-wide supervisor requires the Head of the IAIG to:

- **develop a recovery plan that identifies in advance options to restore the financial position and viability;**
- **review and update the recovery plan on a regular basis, or when there are material changes; and**
- **take actions for recovery if the IAIG comes under severe stress.**

CF 16.15.a.1 The group-wide supervisor should consider the IAIG's nature, scale, and complexity when setting recovery plan requirements, including the form, content and detail of the recovery plan and the frequency for reviewing and updating the plan.

CF 16.15.a.2 Recovery planning is the responsibility of the IAIG. The IAIG should be able to take timely actions for recovery, in particular when any pre-defined criteria are met that trigger the activation of the recovery plan.

CF 16.15.a.3 A recovery plan developed by the IAIG should cover all material legal entities within the group.

CF 16.15.a.4 A recovery plan should serve as a guide for the IAIG to plan and manage severe stress scenarios, although the actual nature and timing of recovery actions will depend on the circumstances.

CF 16.15.a.5 The IAIG should ensure that:

- it has a robust governance structure and sufficient resources to support the recovery planning process, which includes clear allocation of responsibilities; and
- recovery planning is integrated into the IAIG's overall governance processes.

CF 16.15.a.6 A recovery plan is an integral part of the risk management process of an IAIG, aimed at identifying actions to be taken in severe stress scenarios that pose a serious risk to the viability of the IAIG, or any material part of its insurance business. A recovery plan describes if and how the IAIG would:

- discontinue or divest certain portfolios, business lines, legal entities, or other services; and/or
- continue operating certain lines of insurance business while restructuring or running off its discontinued business lines in an orderly fashion.

CF 16.15.a.7 A recovery plan should include:

- a description of the legal entities covered by the plan, including their legal structures, interdependencies, core business lines and main risks;
- a description of functions and/or services that are significant for the continuation of the IAIG (for example,

shared services, such as information technology services and outsourced functions);

- pre-defined criteria with quantitative and qualitative trigger points, governance, escalation mechanisms and supporting processes;
- a range of severe stress scenarios, including both idiosyncratic and market-wide stress;
- credible options to respond to severe stress scenarios, including actions to address capital shortfalls and liquidity pressures, and to restore the financial condition of the IAIG, taking into account intra-group transactions;
- assessment of the necessary steps, costs, resources and time needed to implement the recovery actions, including the risks associated with the implementation of the actions; and
- strategies for communication with stakeholders.

CF 16.15.a.8 Pre-defined criteria should be well-defined and aligned with contingency plans. They should include qualitative and quantitative criteria, such as a potential breach of a prescribed capital requirement (PCR). Criteria may also include triggers based on: liquidity, market conditions, macro-economic conditions, and the insurer's operational conditions.

CF 16.15.a.9 Possible actions for recovery include:

- strengthening the IAIG's capital position, such as recapitalisations;
- capital conservation, such as cost containment and suspension of dividends and of payments of variable remuneration;
- reorganisation of corporate structure and divestitures, such as sales of legal entities or portfolios;
- voluntary restructuring of liabilities, such as debt-to-equity conversion; and
- securing sufficient diversified funding and adequate availability of collateral in terms of volume, location and quality.

CF 16.15.a.10 As a recovery plan may not be able to cover every possible scenario, the IAIG may take, or the group-wide supervisor may require the IAIG to take, measures for recovery other than those contemplated in the IAIG's recovery plan.

CF 16.15.a.11 The group-wide supervisor should regularly review the recovery plan, including the predefined criteria, the assumptions and severe stress scenarios underlying the plan, to assess its credibility and likely effectiveness. Where necessary, the group-wide supervisor should

provide feedback and require the IAIG to address any material deficiencies.

CF 16.15.b The group-wide supervisor requires the Head of the IAIG to have and maintain group-wide management information systems that are able to produce information relevant to the recovery plan on a timely basis.

CF 16.15.b.1 The IAIG may rely on an existing information system, so long as it fulfils the objectives of producing information relevant to the recovery plan on a timely basis.

CF 16.15.b.2 It is important that the IAIG has available the information necessary for executing recovery actions when needed. Some of this information may be similar to the information needed for resolution; however, recovery may also require other information (see ComFrame material under ICP 12 Exit from the Market and Resolution).

Role of supervision in ERM for solvency purposes

16.16 The supervisor undertakes reviews of the insurer's ERM framework, including the ORSA. Where necessary, the supervisor requires strengthening of the insurer's ERM framework, 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. The supervisor should therefore assess the adequacy and soundness of an insurer's framework and processes by receiving regularly the appropriate information, including the ORSA report.

16.16.3 In assessing the soundness, appropriateness and strengths and weaknesses of the insurer's ERM framework, the supervisor should consider questions such as:

- What are the roles and responsibilities within the ERM framework?
- Is the insurer within its stated risk appetite?
- What governance has been established for the oversight of outsourced elements of the ERM framework?
- What modelling and stress testing (including reverse stress testing) is done?
- Has the model risk management been applied in the ERM framework?
- How does the insurer maintain a robust risk culture that ensures active support and adjustment of the insurer's ERM framework in response to changing conditions?

16.16.4 The supervisor 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.

16.16.5 The supervisor should monitor the techniques employed by the insurer for risk management and capital adequacy assessment and take supervisory measures where weaknesses are identified. The supervisor should not take a one-size-fits-all approach to insurers' risk management but rather base their expectations on the nature, scale and complexity of its business and risks. In order to do this, the supervisor should have sufficient and appropriate resources and capabilities. For example, the supervisor may have a risk assessment model or programme with which it can assess insurers' overall condition (eg risk management, capital adequacy and solvency position) and ascertain the likelihood of insurers breaching supervisory requirements. The supervisor may also prescribe minimum aspects that an ERM framework should address.

16.16.6 The supervisor should require the insurer to provide appropriate information on the ERM framework and risk and solvency assessments. This should provide the supervisor with a long-term assessment of capital adequacy to aid in the assessment of insurers, as well as encourage insurers to have an effective ERM framework. This may be achieved also by, the supervisor requiring or encouraging insurers to provide a solvency and financial condition report. Such a report may include information such as:

- a description of the relevant material categories of risk that the insurer faces;
- the insurer's risk appetite and risk limits structure;
- the insurer's 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.

16.16.7 The supervisor should be flexible and apply their skills, experience and knowledge of the insurer in assessing the adequacy of the risk appetite statement. The supervisor may be able to assess the quality of a particular risk appetite statement by discussing with the Board and Senior Management how the insurer's business strategy is related to the risk appetite statement, as well as how the risk appetite had an impact on the insurer's decisions. This includes reviewing other material, such as strategy and planning documents and Board reports in the context of how the Board determines, implements, and monitors its risk appetite so as to ensure that risk-taking is aligned with the Board-approved risk appetite statement.

16.16.8 The supervisor should be provided access to the material results of stress testing, scenario analysis and risk modelling and their key underlying assumptions to be reported to them and have access to other results, if requested. Where the 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. The supervisor should also consider available reverse stress tests performed by insurers where they wish to assess whether appropriate action is being taken to manage the risk of business failure.

16.16.9 While insurers should carry out stress testing, scenario analysis and risk modelling that are appropriate for their businesses, the supervisor may also develop prescribed or standard tests and require insurers to perform them when warranted. 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 condition of the insurance sector to economic, market or other stresses that apply to a number of insurers simultaneously (such as pandemics or major catastrophes). Such tests may be directed to be performed by selected insurers or all insurers. The criteria the supervisor uses for scenarios for standard tests should reflect the jurisdiction's risk environment.

16.16.10 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 the supervisor in assessing the financial condition of insurers. Such testing informs the discussion between the supervisor and insurers on appropriate planning, comparing risk assessments against stress test outcomes, risk management and management actions. The supervisor should 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.

16.16.11 Where an internal model, including an economic capital model, is used in an insurer's ORSA, the supervisor should obtain an understanding of the underlying assumptions used. The supervisor should review the outputs of the internal model, at least from the following viewpoints:

- scope of risk categories of the internal model;
- the insurer's prioritisation of risks in its risk appetite; and
- the insurer's use of the outputs in making major management decisions on capital planning for meeting regulatory capital requirements.

16.16.12 By reviewing the insurer's ORSA continuity analysis, the supervisor may be able to learn about the robustness of an insurer's future financial condition and the information on which the insurer bases decisions and its contingency planning. Such information should enable the supervisor to assess whether an insurer should improve its ERM framework by taking additional countervailing measures and off-setting actions, either immediately, as a preventive measure, or including them in future plans. Objectives of such supervisory measures may be to reduce any projected financial inadequacies, improve cash flows and/or increase an insurer's ability to restore its capital adequacy after stress events.

16.16.13 Publicly disclosing information on risk management may improve the transparency and comparability of existing solvency requirements. There should be an appropriate balance regarding the level of

information to disclose about an insurer's risk management against the level of sufficient information for external and internal stakeholders which is useful and meaningful. Therefore, 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 the supervisor taking into account the proprietary nature of the information.

16.16.14 Where an insurer's risk management and solvency assessment are not considered adequate by the supervisor, the supervisor should take appropriate measures. This could be in the form of further supervisory reporting or additional qualitative and quantitative requirements arising from the supervisor's assessment. Additional quantitative requirements should only be applied in appropriate circumstances and be subject to a transparent supervisory framework. Otherwise, if routinely applied, such measures may undermine a consistent application of standardised approaches to regulatory capital requirements.

Group perspectives

16.16.15 In assessing the soundness, appropriateness and strengths and weaknesses of the group's ERM framework, the group-wide supervisor should consider questions such as:

- 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, and liquidity?

16.16.16 The group-wide supervisor should review the risk management and financial condition of the insurance group. Where necessary, the group-wide supervisor should 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 other involved supervisors of any action required.

16.16.17 The group-wide supervisory review and assessment of the insurance group's ERM framework should consider the framework's 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 supervisory assessment of the group's ERM framework may affect the level of capital that the insurance group is required to hold for regulatory purposes and any regulatory restrictions that are applied. For example, the group-wide supervisor may require changes to 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, the supervisor may consider it appropriate in particular cases that the ORSA should use internal models in order to achieve a sound ERM framework. The quality of an insurance group's ORSA is dependent on how well integrated 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 The supervisor may wish to specify criteria or analyses as part of the supervisory risk assessments to achieve effective supervision and consistency across insurance groups. This may, for example, include prescribed stress tests that apply to insurance groups.

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.[6]

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.[7] 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 and quality of those assets. To allow for the quality of assets, supervisors

[6] It is noted that the total balance sheet approach is an overall concept rather than implying use of a particular methodology.

[7] 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.

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.[8]

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

[8] 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.[9] This is particularly the case in stressed conditions. The latter method may sum surpluses or deficits (ie 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 coordination 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 being a part of the group should be taken into account in capital adequacy assessment.

Establishing regulatory capital requirements

[9] Consolidated accounts may be those used for accounting purposes or may differ (eg in terms of the entities included in the consolidation).

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 (eg 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[10] 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.

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

[10] 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.

- 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 (ie 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 processes (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, eg 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 (eg 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 framework 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.[11]

17.3.7 Other considerations in establishing solvency control levels include:

- 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

[11] 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.

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.[12] 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[13] 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 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.

[12] 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.

[13] To the extent these liabilities are not treated as capital resources.

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.[14] 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[15] 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[16] 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 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

[14] 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.

[15] 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.

[16] 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.

range of intervention actions should be appropriately disclosed by the supervisor.

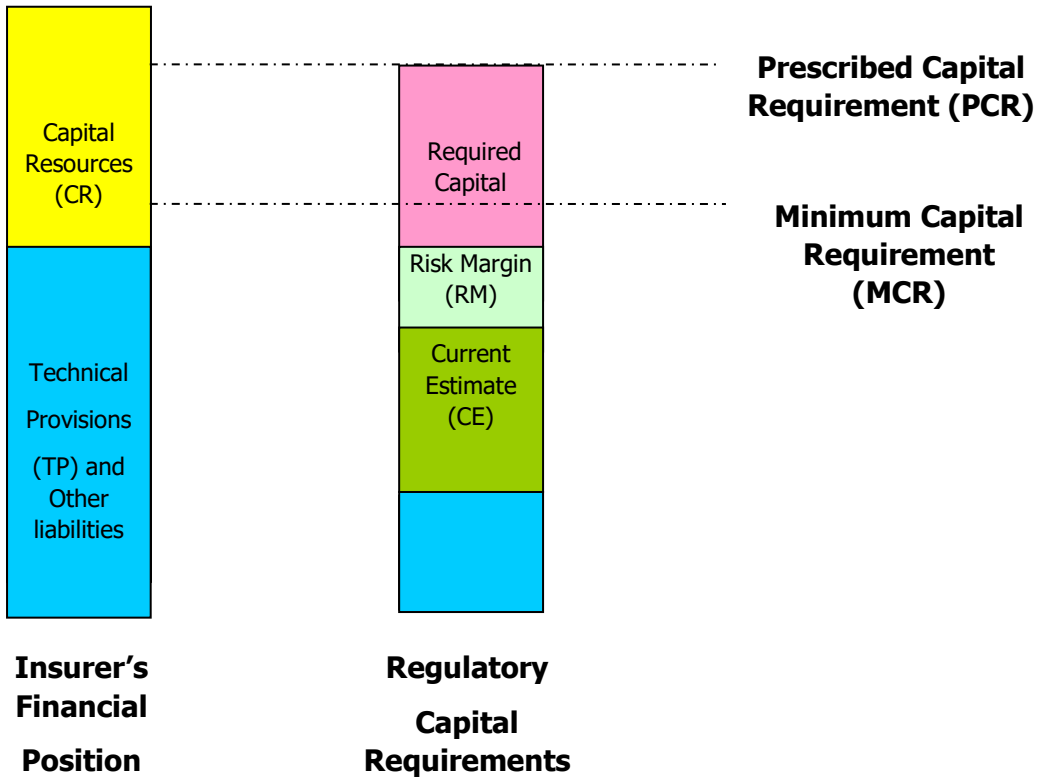
17.4.8 Possible intervention actions include:

- 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, ie the relative weight placed on group-wide supervision and legal entity supervision, and the organisational perspective, ie 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 eg 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, ie 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 (eg 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.[17] 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 (eg 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.[18] 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).

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

[17] 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.

[18] 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.

should take into account the main objective of the MCR (ie 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 at least 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", ie indirect effects to an insurer's exposure caused by an adverse event or a change in economic or financial market conditions.[19] 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 eg 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 effectiveness of the risk transfer and the security of the reinsurance counterparty and any measures used to reduce the reinsurance

[19] For example, a change in the market level of interest rates could trigger an increase of lapse rates on insurance policies.

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,[20] 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 (eg 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).

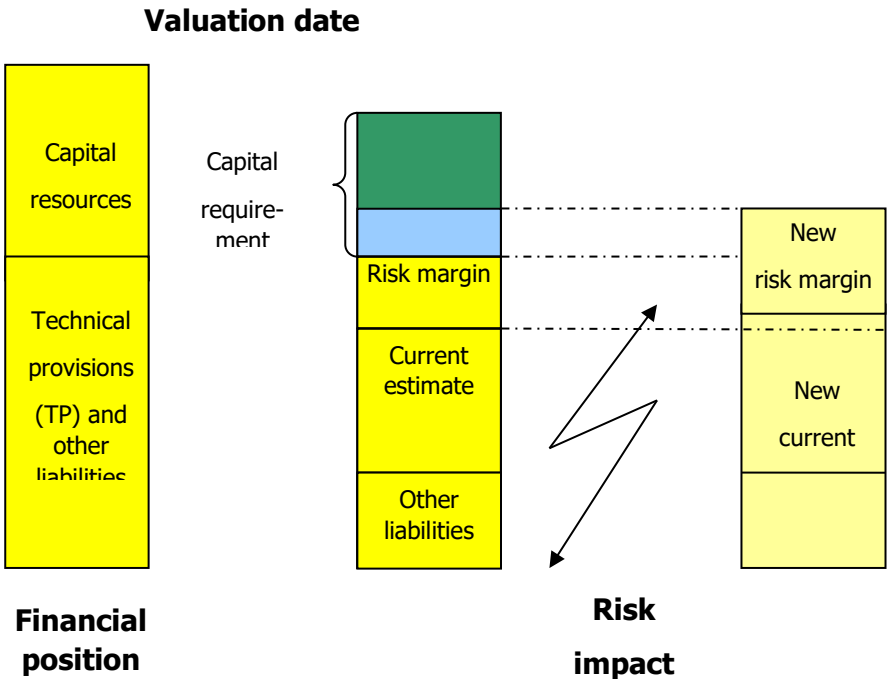
17.8.6 The impact on cash flows of each stress that is assumed to occur during the shock period will need to be calculated over the period for which the shock will affect the relevant cash flows (the effect horizon). In many cases this will be the full term of the insurance obligations. In some cases, 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 technical provisions would allow for the impact of

[20] 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.

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.[21]

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.

[21] See Standard 17.9.

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 entity 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 legal 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 legal

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. 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 (eg 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.

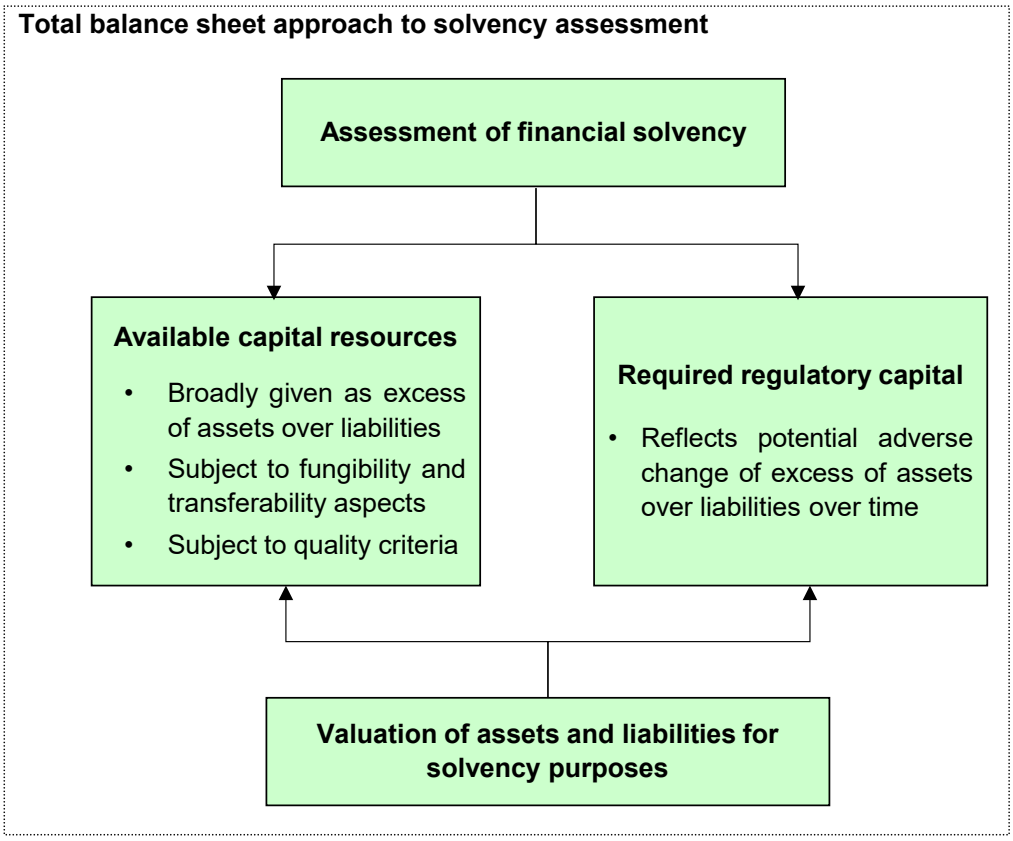
17.10.4 Such an approach requires that the determination of available and required capital is based on consistent assumptions for the recognition and valuation of assets and liabilities for solvency purposes.

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.[22]

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.

[22] Refer to Guidance 17.3.1 - 17.9.5.

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.[23] 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.[24]

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;

[23] However, adequate recognition should be given to contractual features of the debt such as embedded options which may change its loss absorbency.
[24] 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.

- 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[25] 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 eg 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 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 – ie 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

[25] These investments include investment in the equity of, loans granted to, deposits with and bonds issued by the related parties.

should take into account the estimation uncertainty[26] 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 - ie 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 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:

[26] 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.

- 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, eg 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 eg 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 ie 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:

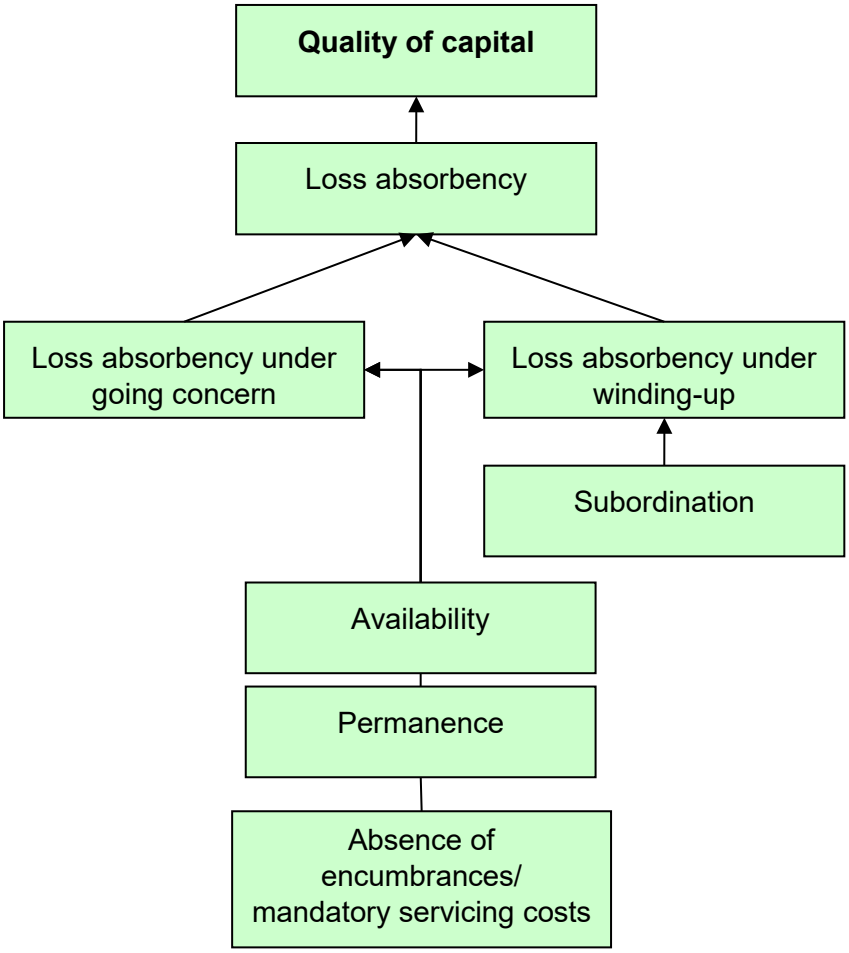
- the extent to which and in what circumstances the capital element is subordinated to the rights of policyholders in an insolvency or winding-up (subordination);

- 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.[27] 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 (eg 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.

[27] Rights of offset will vary according to the legal environment in a jurisdiction.

17.11.16 However, in some circumstances, a capital element may be paid for "in kind" ie 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 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;[28]
- contractual features of the capital instrument which have an effect on the period for which the capital is available, eg lock-in clauses, step-up options or call options;
- any supervisory powers to restrict the redemption of capital resources; and
- 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

[28] The duration of the insurer's obligations to policyholders should be assessed on an economic basis rather than strict contractual basis.

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 (ie 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;[29]

- 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[30] (for example, a minimum level of 50%[31] 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

[29] Capital elements categorised as being of highest quality are often referred to as core capital and lower levels as supplementary capital, or similar.
[30] Alternative approaches may also be used in practice, for example, where the levels are expressed as a percentage of available capital.
[31] The percentages used may vary for supervisors in different jurisdictions

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 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[32] needs; and
- a means to determine an insurer's regulatory capital resources and requirements, where appropriate.

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,[33] 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[34] – 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

[32] 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.
[33]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).
34 Refer to Guidance 17.12.14 in relation to "cherry-picking" in the particular context of partial internal models.

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.

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 (ie 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[35] calibrated confidence level over a one year timeframe,[36] a 99% TVaR[37] over one year[38] 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

[35] VaR – Value at Risk – an estimate of the worst expected loss over a certain period of time at a given confidence level.
[36] 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.
[37] TVaR – Tail Value at Risk – the VaR plus the average exceedence over the VaR if such exceedence occurs
[38] These are the modelling criteria of the Swiss Solvency Test.

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 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 eg 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[39] 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

[39] 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.

regulatory capital requirements and regulatory capital requirements of individual insurance legal entities.

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 eg 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, at least, 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 least, 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.[40] 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 (eg 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 involved 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 eg 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

[40] Validation should be carried out by a different department or personnel to those that created the internal model to facilitate independence.

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 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, eg 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, eg 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 (eg 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 (eg 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 legal 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 Where an internal model is established to assess risks at a modular level, ie 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, eg 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 The documentation of the group-wide internal model should include at least:

- 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 entities;
- 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, eg 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.[41]

[41] 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

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 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 processes 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 legal 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 legal entity level the supervisor may consider whether the legal 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 may 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:

- 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 processes 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 framework, including 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 processes, 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 processes 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 may 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 processes 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 processes 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 least:

- **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 may 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 (see Application Paper on Supervising the Conduct of Intermediaries).

18.5.18 Additionally, circumstances in which conflicts of interest may arise may be covered in the codes of conduct issued by SROs or other professional bodies.

18.5.19 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 processes 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 processes 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 material 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 processes 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 processes;
- 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

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 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 insurer-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 processes 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 processes 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 processes 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 processes in place to achieve the fair treatment of customers and should monitor whether such policies and processes are adhered to.

19.2.2 Proper policies and processes 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 processes 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 processes 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 processes 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 processes 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 processes publicly available as good practice, in particular their claims handling, complaints handling and dispute resolution policies and processes.

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 may include 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 processes.

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 may 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 applicable laws 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; and
- Right to complain – including the arrangements for handling policyholders' complaints, which may 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 supervisor 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 processes 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 least 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 processes 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 processes 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 processes 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 may 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 processes 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 processes 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 processes in place. Such policies and processes 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 may 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 processes to protect the privacy of personal information on customers, depending on the jurisdiction, the 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 processes in place. The measures that the supervisor should expect such policies and processes 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 processes 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 processes 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 processes to prevent the use of customer information in a manner that results in unfair treatment, depending on the jurisdiction, the 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 processes 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 and comprehensive information on a timely basis in order to give policyholders and market participants a clear view of their business activities, risks, performance and financial position.

Introductory Guidance

20.0.1 Public disclosure of material information is expected to enhance market discipline by providing meaningful and useful information to policyholders to make decisions on insuring risks with the insurer, and to market participants (which includes existing and potential investors, lenders and other creditors) to make decisions about providing resources to the insurer.

20.0.2 So far as practicable, information should be presented in accordance with any applicable jurisdictional, international standards or generally accepted practices so as to aid comparisons between insurers.

20.0.3 In setting public disclosure requirements, the supervisor should take into account the information provided in general purpose financial statements and complement it as appropriate. The supervisor should note that insurers which provide public general purpose financial reports may largely comply with jurisdictional disclosure standards that are reflective of this ICP. Where a supervisor publishes on a regular and timely basis information received from insurers, the supervisor may decide that those insurers do not need to publicly disclose that same information.

20.0.4 To the extent that there are differences between the methodologies used in regulatory reporting, general purpose financial reporting and any other items for public disclosure, such differences should be explained and reconciled where possible.

20.0.5 The supervisor's application of disclosure requirements will depend on the nature, scale and complexity of insurers. For example, it may be overly burdensome for a small, private insurer to meet the same requirements developed for large, publicly traded insurers. While disclosure requirements may vary, the outcome should promote market discipline and provide policyholders and market participants with adequate information for their needs.

20.0.6 Additionally, the supervisor may decide not to apply disclosure requirements if 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. It is expected that such situations would be exceptional, but could be more relevant for certain types of insurers (for example, captive insurers).

20.0.7 Public disclosure may include a description of how information is prepared, including methods applied and assumptions used. Disclosure of methods and assumptions may assist policyholders and market participants in making 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 be made only where there is adequate disclosure of how information is prepared.

20.0.8 Similarly, meaningful comparisons from one reporting period to another can be made only 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 may 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 will assist in the understanding of trends over time.

20.0.9 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 may be helpful if information is presented in a manner that facilitates the identification of patterns over time, including providing comparative or corresponding figures from previous periods (eg by presenting loss triangulations).

20.0.10 In establishing disclosure requirements for its jurisdiction, the supervisor should consider the need for disclosures that deliver key information rather than unnecessary volumes of data. Excessive disclosure requirements will not lead to effective disclosures for policyholders and market participants and will be burdensome for insurers.

20.0.11 In establishing disclosure requirements, the supervisor should take into account proprietary and confidential information. Proprietary information comprises information on characteristics and details of, for example, insurance products, markets, distribution and internal models and systems that could negatively influence the competitive position of an insurer if made available to competitors. Information about policyholders and insured parties is usually confidential under privacy legislation or contractual arrangements.

20.0.12 Proprietary and confidential information affects the scope of the required disclosure of information by insurers about their customer base and details on internal arrangements (for example, methodologies used or parameter estimates data). The supervisor should strike an appropriate balance between the need for meaningful disclosure and the protection of proprietary and confidential information.

20.0.13 A consolidated group as determined under applicable accounting standards may differ from a group for the purposes of insurance supervision (see ICP 23 Group-wide Supervision). In circumstances where this is the case, the supervisor may require disclosures based on the scope of the group for supervisory purposes. Where an insurer's scope of the group is different under applicable accounting standards and solvency standards, it may be appropriate if reasons are provided and an explanation given about the basis on which disclosures have been provided.

20.0.14 Disclosures by insurance legal entities may cross-refer to existing public disclosures to avoid duplication.

20.1 Subject to their nature, scale and complexity, insurers make audited financial statements available at least annually.

20.1.1 Where audited financial statements are not required by the supervisor given the nature, scale and complexity of an insurer (for example, for a small local branch office of a foreign insurer), the supervisor may require that similar information is made publicly available by other means.

20.2 Insurers disclose, at least annually and in a way that is publicly accessible, appropriately detailed information on their:

- **company profile;**
- **corporate governance framework;**
- **technical provisions;**
- **insurance risk exposure;**
- **financial instruments and other investments;**
- **investment risk exposure;**
- **asset-liability management;**
- **capital adequacy;**
- **liquidity risk; and**
- **financial performance.**

20.2.1 In developing disclosure requirements, the supervisor may consider whether such disclosures are:

- easily accessible and up-to-date;
- comprehensive, reliable and meaningful;
- comparable between different insurers operating in the same market;
- consistent over time so as to enable relevant trends to be discerned; and
- aggregated or disaggregated so that useful information is not obscured.

20.2.2 Information should be disseminated in ways best designed to bring it to the attention of policyholders and market participants, but taking into account the relative effectiveness and costs of different methods of dissemination (for example, printed versus digital methods).

20.2.3 Information should be provided with sufficient frequency and timeliness to give a meaningful picture of the insurer to policyholders and market participants. The need for timeliness will need to be balanced against that for reliability.

20.2.4 Disclosure requirements may also have to balance the interests of reliability against those of relevance or usefulness. 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 a high degree of 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.

20.2.5 Information should be sufficiently comprehensive to enable policyholders and 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, information should be:

- well-explained so that it is meaningful;
- complete so that it covers all material circumstances of an insurer and, where relevant, those of the group of which it is a member; and
- 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.

20.2.6 Information should, so far as practicable, reflect the economic substance of events and transactions as well as their legal form. The information should be neutral (ie, free from material error or bias) and complete in all material respects.

Company Profile

20.3 Disclosures include information about the insurer's company profile such as:

- **the nature of its business;**
- **its corporate structure;**
- **key business segments;**
- **the external environment in which it operates; and**
- **its objectives and the strategies for achieving those objectives.**

20.3.1 The overall aim for the company profile disclosure is for insurers to provide a contextual framework for the other information required to be made public.

20.3.2 Disclosures on the nature of the insurer's business and its external environment should assist policyholders and market participants in assessing the strategies adopted by the insurer.

20.3.3 Disclosures may include information about the insurer's corporate structure, which should include any material changes that have taken place during the year. For insurance groups, where provided, such disclosures should focus on material aspects, both in terms of the legal entities within the corporate structure and the business functions undertaken within the group. In the event of differences in the composition of a group for supervisory purposes and for public reporting purposes, it would be useful if a description of the entities constituting those differences was also provided.

20.3.4 Disclosures may include information on the key business segments, main trends, factors and events that have contributed positively or negatively to the development, performance and position of the company.

20.3.5 Disclosures may include information on the insurer's competitive position and its business models (such as its approach to dealing and settling claims or to acquiring new business) as well as significant features of regulatory and legal issues affecting its business.

20.3.6 Disclosures may include information about company objectives, strategies and timeframes for achieving those objectives, including the approach to risk appetite, methods used to manage risks, and key resources available. To enable policyholders and 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.

20.3.7 Key resources available may include both financial and non-financial resources. For non-financial resources the insurer may, for example, provide information about its human and intellectual capital.

Corporate Governance Framework

20.4 The supervisor requires that disclosures about the insurer's corporate governance framework provide information on the key features of the framework, including its internal controls and risk management, and how they are implemented.

20.4.1 Disclosures should include the manner in which key business activities and control functions are organised, and the mechanism used by the Board to oversee these activities and functions, including for changes to key personnel and management committees. Such disclosures should demonstrate how the key activities and control functions fit into an insurer's overall risk management framework.

20.4.2 Where a material activity or function of an insurer is outsourced, in part or in whole, disclosures may include the insurer's outsourcing policy and how it maintains oversight of, and accountability for, the outsourced activity or function.

Technical Provisions

20.5 The supervisor requires that disclosures about the insurer's technical provisions are presented by material insurance business segment and include, where relevant, information on:

- **the future cash flow assumptions;**
- **the rationale for the choice of discount rates;**
- **the risk adjustment methodology where used; and**
- **other information as appropriate to provide a description of the method used.**

20.5.1 Disclosures related to technical provisions should provide information on how those technical provisions are determined. As such, disclosures may include information about the level of aggregation used and the amount, timing and uncertainty of future cash flows in respect of insurance obligations.

20.5.2 Disclosures should include a presentation of technical provisions and reinsurance assets on a gross basis. However, it may be useful to have

information about technical provisions presented on both a net and gross basis.

20.5.3 Information may be disclosed about the method used to derive the assumptions for calculating technical provisions, including the discount rate used. Disclosures may also include information about significant changes in assumptions and the rationale for the changes.

20.5.4 When applicable, information about the current estimate and margin over the current estimate may include the methods used to calculate them, whether or not these components of technical provisions are determined separately. If the methodology has changed since the last reporting period, it would be useful to include the reasons for the change and any material quantitative impact.

20.5.5 It may be useful if the insurer provides an outline of any model(s) used and describe how any range of scenarios regarding future experience has been derived.

20.5.6 Disclosures may include a description of any method used to treat acquisition costs and whether future profits on existing business have been recognised.

20.5.7 Where surrender values are material, disclosures may include the insurer's surrender values payable.

20.5.8 Disclosure of a reconciliation of technical provisions from the end of the previous year to the end of the current year may be particularly useful.

20.5.9 Disclosure of technical provisions may be presented in two parts:

- one part that covers claims from insurance events which have already taken place at the date of reporting (claims provisions including incurred but not reported (IBNR) and incurred but not enough reported (IBNER) provisions) and for which there is an actual or potential liability; and
- another part that covers losses from insurance events which will take place in the future (for example, the sum of provision for unearned premiums and provision for unexpired risks (also termed premium deficiency reserve)).

20.5.10 Providing this disclosure in two parts is particularly important for lines of insurance business where claims may take many years to settle.

Life insurers

20.5.11 It may be useful if the disclosures include key information on the assumed rates, the method of deriving future mortality and disability rates, and whether customised tables are applied. Disclosures may include a life insurer's significant assumptions about future changes of mortality and disability rates.

20.5.12 It may enhance policyholder and market participant understanding if disclosures include information on the conditions for the amount and timing of the allocation of participation features and how such features are valued in technical provisions. Required disclosures could include whether participation features are based on: the performance of a group of contracts; the realised/unrealised investment returns from a pool of

assets; the profit or loss of the company; or any other element. Disclosures could also be required on the extent to which such features are contractual and/or discretionary.

20.5.13 Disclosures may include quantitative information on the life insurer's minimum participation features and actual distributions to policyholders. For example, the following quantitative information may be shown by segment:

- guaranteed policyholder benefits paid; and
- additional policyholder benefits paid which arise from profit sharing clauses.

20.5.14 Disclosures may include the assumptions and methodologies employed to value significant guarantees and options, including the assumptions concerning policyholder behaviour.

Non-life insurers

20.5.15 In order to enable policyholders and market participants to evaluate trends, disclosures for non-life insurers may include 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, historical data on the run off result and claims development could be disclosed.

20.5.16 To facilitate the evaluation of a non-life insurer's ability to assess the size of the commitments to indemnify losses covered by the insurance contracts issued, disclosures for non-life insurers may include the run off results over many years, to enable policyholders and market participants to evaluate long-term patterns (for example, how well the insurer estimates the technical provisions). The length of the time period should reflect how long-tailed the distribution of losses is for the insurance classes in question.

20.5.17 Non-life insurers may disclose information on the run off results for incurred losses and for the provisions for future losses.

20.5.18 Disclosures for non-life insurers may include the run off results as a ratio of the initial provisions for the losses in question. When discounting is used, disclosures should include the effect of discounting.

20.5.19 Except for short-tail business, the supervisor may require non-life insurers to disclose information on the development of claims in a claims development triangle. A 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 reconciled to amounts reported in the balance sheet.

Insurance Risk Exposures

20.6 The supervisor requires that disclosures about the insurer's reasonably foreseeable and material insurance risk exposures, and their management, include information on:

- **the nature, scale and complexity of risks arising from its insurance contracts;**
- **the insurer's risk management objectives and policies;**
- **models and techniques for managing insurance risks (including underwriting processes);**
- **its use of reinsurance or other forms of risk transfer; and**
- **its insurance risk concentrations.**

20.6.1 Disclosures may include a quantitative analysis of the insurer's sensitivity to changes in key factors both on a gross basis and taking into account the effect of reinsurance, derivatives and other forms of risk mitigation on that sensitivity. For example, disclosures may include a sensitivity analysis by life insurers to the changes in mortality and disability assumptions or sensitivities to increased claim inflation by non-life insurers.

20.6.2 Where an insurance group includes legal entities in other sectors, disclosures may include the risk exposure of the insurance legal entities from those other entities and procedures in place to mitigate those risks.

20.6.3 Disclosures may include a description of the insurer's risk appetite and its policies for identifying, measuring, monitoring and controlling insurance risks, including information on the models and techniques used.

20.6.4 Disclosures may include information on the insurer's use of derivatives to hedge risks arising from insurance contracts. This information may include a summary of internal policies on the use of derivatives.

20.6.5 Disclosure of how an insurer uses reinsurance and other forms of risk transfer may enable policyholders and market participants to understand how the insurer controls its exposure to insurance risks.

20.6.6 Quantitative data on an insurer's reinsurance Disclosure may include the insurer's overall reinsurance programme to explain 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.

20.6.7 It may be beneficial if disclosures separately detail the reinsurers' share of technical provisions and receivables from reinsurers on settled claims. Further quantitative disclosures on reinsurance may include:

- the credit quality of the reinsurers (for example, by grouping reinsurance assets by credit rating);
- credit risk concentration of reinsurance assets;
- the nature and amount of collateral held against reinsurance assets;
- the development of reinsurance assets over time; and
- the ageing of receivables from reinsurers on settled claims.

20.6.8 It may be useful if disclosures include the impact and planned action when the expected level or scope of cover from a reinsurance/risk transfer contract is not obtained.

20.6.9 Description of the insurer's risk concentrations may include, at least, information on the geographical concentration of insurance risk, the economic sector concentration of insurance risk, the extent to which the risk is reduced by reinsurance and other risk mitigating elements and, if material, the risk concentration inherent in the reinsurance cover.

20.6.10 Disclosures may include the geographical concentration of premiums. The geographical concentration may be based on where the insured risk is located, rather than where the business is written.

20.6.11 If material, disclosures may include the number of reinsurers that it engages, as well as the highest concentration ratios. For example, it would be appropriate to expect an insurer to disclose its 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.

Financial Instruments and Other Investments

20.7 The supervisor requires that disclosures about the insurer's financial instruments and other investments include information on:

- **instruments and investments by class;**
- **investment management objectives, policies and processes; and**
- **values, assumptions and methods used for general purpose financial reporting and solvency purposes, as well as an explanation of any differences, where applicable.**

20.7.1 For the purposes of disclosure, an insurer may group assets and liabilities with similar characteristics and/or risks into classes and then disclose information segregated by those classes.

20.7.2 Where investment management objectives, policies and processes differ between segments of an insurer's investment portfolio, disclosures should be sufficient to provide an understanding of those differences.

20.7.3 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 also disclosed.

Investment Risk Exposures

20.8 The supervisor requires disclosures about the insurer's material investment risk exposures, and their management.

20.8.1 Disclosures may include quantitative information, about its exposure to:

- currency risk;
- market risk;
- credit risk; and
- concentration risk.

20.8.2 The risks listed above may affect both assets and liabilities. For example, market risk arising from interest rate movement may be reflected in changes in the valuation of an insurer's fixed income investments as well as changes in the valuation of insurance liabilities if they are discounted using market interest rates. Changes in interest rates may also change the amounts that an insurer has to pay for its variable rate borrowings. Therefore, required disclosure may include the risk exposure arising from both an insurer's assets and its liabilities.

20.8.3 Disclosures may include the investment return achieved together with the risk exposure and investment objective. Disclosure of risk exposures can provide policyholders and 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.

20.8.4 For investment risk exposures, disclosures may include the intra-period high, median and low exposures where there have been significant changes in exposure since the last reporting date. Disclosures may also include the amount bought and sold during a reporting period as a proxy for turnover. Such disclosure of risk exposures may also be required for each asset class.

20.8.5 In jurisdictions that require investment disclosures to be grouped by risk exposure, the disclosures should provide information about the risk management techniques used to measure the economic effect of risk exposure. Such disclosure may include an analysis by type of asset class.

20.8.6 Disclosures may include information on its use of derivatives to hedge investment risks, including a summary of internal policies on the use of derivatives.

20.8.7 Disclosures may include information on whether or not the insurer it carries out stress tests or sensitivity analysis on its investment risk exposures (for example, the change in capital resources as a percentage of total assets corresponding to a 100 basis point change in interest rates), and, if so, disclose the model, process and types of assumptions used and the manner in which the results are used as part of its investment risk management practices.

20.8.8 For debt securities, disclosures on the sensitivity of values to market variables including credit spreads may include breakdowns by credit rating of issue, type of issuer (eg government, corporate) and by period to maturity.

20.8.9 In addition to breakdowns on ratings and types of credit issuers, the insurer should disclose the aggregate credit risk arising from off-balance sheet exposures.

Asset-Liability Management

20.9 Disclosures about the insurer's asset-liability management (ALM) include information on:

- **ALM in total and, where appropriate, at a segmented level;**

- **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.**

20.9.1 To provide information on its ALM approach, disclosures may include qualitative information explaining how the insurer manages assets and liabilities in a co-ordinated manner. 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.

20.9.2 Where an insurer's ALM is segmented (eg by different lines of business), disclosures may include information on ALM at a segmented level.

20.9.3 Where derivatives are used, it may be useful if the disclosures include a description of both the nature and effect of their use.

20.9.4 Disclosures may include the insurer's sensitivity of regulatory capital resources and provisions for mismatching to:

- changes in the value of assets; and
- changes in the discount rate or rates used to calculate the value of the liabilities.

Capital Adequacy

20.10 Disclosures about the insurer's capital adequacy include information on:

- **its objectives, policies and processes for managing capital and assessing capital adequacy;**
- **the solvency requirements of the jurisdiction(s) in which the insurer operates; and**
- **the capital available to cover regulatory capital requirements. If the insurer uses an internal model to determine capital resources and requirements, information about the model is disclosed.**

20.10.1 Information about objectives, policies and processes for managing capital adequacy assist in promoting the understanding of risks and measures which influence the capital calculation and the risk appetite that is applied.

20.10.2 It may be useful if the insurer discloses information to allow market participants to assess the quantity and quality of its capital in relation to regulatory capital requirements.

20.10.3 Disclosures may include qualitative information about its management of capital regarding:

- instruments regarded as available capital;
- key risks and measures which influence the capital calculation; and
- the insurer's risk appetite.

20.10.4 It may be useful if the disclosures include a description of any variation in the group as defined for capital adequacy purposes from the composition of the group used for general purpose financial reporting purposes.

Liquidity Risk

20.11 The supervisor requires that disclosures about the insurer's liquidity risk include sufficient quantitative and qualitative information to allow a meaningful assessment by market participants of the insurer's material liquidity risk exposures.

20.11.1 Disclosures on liquidity risk should include:

- quantitative information on the insurer's sources and uses of liquidity, considering liquidity characteristics of both assets and liabilities; and
- qualitative information on the insurer's liquidity risk exposures, management strategies, policies and processes.

20.11.2 Disclosures should discuss known trends, significant commitments and significant demands. Disclosures should also discuss reasonably foreseeable events that could result in the insurer's liquidity position improving or deteriorating in a material way.

Financial Performance

20.12 Disclosures about the insurer's financial performance, in total and at a segmented level include information on:

- **earnings analysis;**
- **claims statistics including claims development;**
- **pricing adequacy; and**
- **investment performance.**

General financial performance

20.12.1 Disclosures should help policyholders and market participants better understand how profit emerges over time from new and in-force insurance contracts.

20.12.2 Disclosure may include a statement of changes in equity showing gains and losses recognised directly in equity as well as capital transactions with, and distributions to, shareholders, and profit sharing with policyholders.

20.12.3 Disclosures may include information on its operating segments and how they were determined.

20.12.4 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. Examples of features by which business is segmented are:

- type of business: life insurance, non-life insurance, investment management; and

- mix of organisational and geographic approach: eg insurance jurisdiction X, insurance jurisdiction Y, insurance (other), asset management jurisdiction Z.

20.12.5 Disclosures may include the impact of amortisation and impairment of intangible assets on financial performance.

Technical performance

20.12.6 The insurer may provide statements of profit and loss that include the results, both gross and net of reinsurance, of their underwriting by broad lines of business.

20.12.7 , If the insurer is a ceding insurer, disclosures may include gains and losses recognised in profit or loss on buying reinsurance.

Technical performance for non-life insurers

20.12.8 In order to judge how well insurance premiums cover the underlying risk of the insurance contracts and the administration expenses (pricing adequacy), disclosures may include data on:

- loss ratio;
- expense ratio;
- combined ratio; and
- operating ratio.

20.12.9 These ratios should be calculated from the profit and loss account of the reporting year and be gross of reinsurance in order to neutralise 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. 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.

20.12.10 When discounting is used, disclosures may include information on the discount rates used and method of discounting to be disclosed. The discount rates should be disclosed at an appropriate level of aggregation by duration, for example, for each of the next five years and the average rate for claims expected to be paid after five years.

20.12.11 Such disclosure should be accompanied by supporting narrative, covering an appropriate period, to enable policyholders and market participants to evaluate long-term trends better. Information relating to previous years should not be recalculated to take into account present information. The length of the period may reflect the historical volatility of the particular class of insurance business.

20.12.12 It may be appropriate in the case of high volume, homogeneous classes, for the supervisor to require insurers to disclose statistical information on claims. For instance, the insurer could describe the trend in the number of claims and the average size of claims. To be relevant, this information should be linked to the level of business (eg number of policies or earned premiums).

20.12.13 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. However, , it would be normal for non-life insurers to be required to disclose historical data accompanied by supporting narrative at least on:

- the mean cost of claims incurred (ie, the ratio of the total cost of claims incurred to the number of claims) in the accounting period by class of business; and
- 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).

Source of earnings analysis for life insurers

20.12.14 Where an applicable jurisdictional standard does not require a similar analysis to be disclosed, it may be useful for disclosures to include 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. Examples of this include expected release of risk margins, net management fees, and earnings on deposits.

20.12.15 Life insurers may 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 is also affected by any methodology used to defer and amortise acquisition expenses.

20.12.16 It may be useful for life insurers to 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.

20.12.17 Life insurers may disclose the impact on earnings of management actions and changes in assumptions.

20.12.18 An example of a Source of Earnings analysis table for a life insurer is provided below.

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 **Additional items:** **Changes in assumptions** **Earnings on surplus** **Other** **Income taxes** **= Net income**						

Investment performance

20.12.19 Investment performance is one of the key determinants of an insurer's profitability. For many life insurance policies, returns that policyholders receive are either directly or indirectly influenced by the performance of an insurer's investments. Disclosure of investment performance is, therefore, essential to policyholders and market participants.

20.12.20 Disclosure of investment performance may be 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).

20.12.21 For investment performance related to equity securities, debt securities, properties and loans, the disclosures may include a breakdown of income (eg dividend receipts, interest income, rental income), realised gains/losses, unrealised gains/losses, impairments including changes in loan loss provisions and investment expenses.

Non-GAAP Financial Measures

20.13 Insurers that publicly disclose non-GAAP financial measures are required to adhere to the specified practices regarding those measures, where applicable.

20.13.1 In many jurisdictions, publicly-listed insurers are expected to adhere to specific practices, for disclosure of non-GAAP financial measures, which have been promulgated by the domestic securities supervisor. The supervisor could consider standards promulgated by the domestic securities supervisor appropriate.

20.13.2 If no such requirements exist from the domestic securities supervisor for non-GAAP financial measures, the supervisor may promulgate requirements for insurers based on considerations of best practices and existing international guidance from key standard setting bodies dealing with financial disclosures.

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 (see Application Paper on Deterring, Preventing, Detecting, Reporting and Remedying Fraud in Insurance).

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.

21.1 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. The supervisor should at least 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; and
- 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 may 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

The supervisor requires insurers and intermediaries to take effective measures to combat money laundering and terrorist financing. The supervisor takes effective measures to combat money laundering and terrorist financing.

Introductory Guidance

22.0.1 The insurance sector is potentially at risk of being misused for money laundering and terrorist financing. This exposes the insurance sector to legal, operational and reputational risks.

22.0.2 Money laundering (ML) is the processing of criminal proceeds to disguise their illegal origin. When criminal activity generates substantial profits, the individual or group involved must find a way to control and "legitimize" funds without attracting attention to the underlying activity or the persons involved. Criminals do this by disguising the sources, changing the form, or moving the funds to a place where they are less likely to attract attention, and therefore may use the financial sector, including the insurance sector, to do so. Examples of criminal activity which may generate large profits and lead to money laundering include embezzlement, tax evasion, insider trading, bribery, cyber-crimes, illegal arms sales, smuggling, drug trafficking, prostitution, human trafficking, as well as corruption and organised crime.

22.0.3 Terrorist financing (TF) is the financing of terrorist acts, and of terrorists and terrorist organisations. It refers to 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 by a terrorist organisation or by an individual terrorist, or to support terrorists or terrorist organisations. Terrorist financing offenses may constitute predicate offenses for the crime of money laundering, in accordance with applicable law.

22.0.4 The Financial Action Task Force (FATF) is an inter-governmental body, established to set international standards for anti-money laundering (AML) and combating the financing of terrorism (CFT). The FATF standards are comprised of its individual recommendations together with interpretive notes and the applicable definitions in the FATF glossary. In this ICP the term FATF Recommendations encompasses all of these components of the FATF standards. The FATF Recommendations are directed at jurisdictions and supervisors should therefore reference their own national risk assessment, applicable laws and regulations with respect to AML/CFT.

22.0.5 The IAIS is a FATF Observer Organisation and, accordingly, endorses the FATF Recommendations. This ICP is intended to be consistent with the FATF Recommendations; however, compliance with the FATF Recommendations does not necessarily imply observance of ICP 22 nor does observance of ICP 22 necessarily imply compliance with the FATF Recommendations.

22.0.6 According to the FATF:

- the ML/TF risks associated with the insurance sector are generally lower than those associated with other financial products (such as loans or payment services) or other sectors (such as banking); and
- many life insurance products are not sufficiently flexible to be the first vehicle of choice for money launderers.

However, as with other financial products, there is a risk that the funds used to purchase life insurance may be the proceeds of crime.

22.0.7 This ICP applies to the underwriting and placement of life insurance and other investment-related insurance. Depending upon the jurisdiction's assessment of the ML/TF risk posed by the non-life sector, the jurisdiction should consider whether and to what extent to apply this ICP to that sector as well.

22.0.8 The FATF Recommendations require jurisdictions to designate a "competent authority" or authorities to have responsibility for ensuring that financial institutions (including insurers and intermediaries) adequately comply with the jurisdiction's approach to implementing the FATF Recommendations to combat ML/TF. 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. Competent authorities may include supervisors, law enforcement agencies and a financial intelligence unit (FIU) which serves as a jurisdictional centre for receiving and analysing information (such as suspicious transaction reports) and disseminating information regarding potential ML/TF.

22.0.9 In some jurisdictions, the supervisor may not be designated as an AML/CFT competent authority, but nevertheless all supervisors must understand the risk of ML/TF to the insurance sector and take steps to help combat such risk.

22.0.10 The standards and guidance related to ICP 22 are divided into two parts. Part A applies where the supervisor is a designated AML/CFT competent authority, or acts on behalf of such designated competent authority. Part B applies where the supervisor is not a designated AML/CFT competent authority. To demonstrate observance of this ICP the supervisor must meet the requirements of the standards in either Part A or Part B, or both, according to the circumstances of its jurisdiction.

22.0.11 In implementing this ICP, the supervisor may consider as relevant various guidance available from the FATF, including its "Guidance for a Risk-Based Approach for the Life Insurance Sector" (FATF Guidance). The FATF Guidance, which is non-binding, aims to support the design and implementation of a Risk-Based Approach (RBA) to AML/CFT for the life insurance sector, taking into account applicable ML/TF risk assessments and legal and regulatory frameworks to combat money laundering and terrorist financing. The RBA concept is related to, but distinct from, the overarching concept of risk-based supervision that applies to all ICPs.

22.0.12 As described in the ICP Introduction, this ICP applies to the supervision of insurance legal entities and, unless otherwise specified, to insurance groups. The supervisor may also consider FATF Guidance concerning supervision and mitigation of ML/TF risks at the group-wide level.

22.0.13 Certain FATF Recommendations require that supervision be applied to the implementation of targeted financial sanctions (TFS) related to terrorism, terrorist financing and financing of proliferation of weapons of mass destruction. Adherence to TFS is not subject to the RBA described in this ICP and TFS is not further addressed in this ICP. Whether insurance supervisors have responsibilities for TFS will depend upon the particular jurisdictional arrangements in place.

Part A: ***Where the supervisor is a designated AML/CFT competent authority***

22.1 **The supervisor:**

- **has a thorough and comprehensive understanding of the ML/TF risks to which insurers and/or intermediaries are exposed;**
- **uses available information to assess the ML/TF risks to the insurance sector in its jurisdiction on a regular basis; and**
- **applies a Risk-Based Approach (RBA) consistent with FATF Recommendations.**

22.1.1 Consistent with the FATF Recommendations, RBA refers to:

- the general process by which a supervisor, according to its identification, understanding and assessment of risks, allocates its resources to AML/CFT supervision; and
- the specific process of supervising institutions (ie insurers and intermediaries, as applicable) that apply an AML/CFT RBA.

Understanding ML/TF risks

22.1.2 The supervisor should have a thorough and comprehensive understanding of the ML/TF risks to which insurers and intermediaries are exposed arising from the activities undertaken and products and services offered by insurers and intermediaries.

22.1.3 In the context of ML/TF, “risk” encompasses threats, vulnerabilities, and consequences in relation to products (including services and transactions), geography, customers and delivery channels.

22.1.4 Some of the examples of attributes included below can be expected over the course of a long-term insurance contract and are not necessarily inherently suspicious, but rather should be viewed as factors to consider with respect to AML/CFT RBA.

22.1.5 Product-related risk refers to the vulnerability of a product to ML/TF based on its design. The following are examples of product attributes which may tend to increase the ML/TF risk profile:

- acceptance of very high value or unlimited value payments or large volumes of lower value payments;

- acceptance of non-traceable payments such as cash, money orders, cashier cheques, or virtual assets;
- acceptance of frequent payments outside a normal premium or payment schedule;
- allowance of withdrawals at any time or early surrender, with limited charges or fees;
- products that allow for high cash values;
- products that accept high amount lump sum payments, coupled with liquidity features;
- products with provisions that allow a policy to be cancelled within a stipulated timeframe and the premiums paid to be refunded; and
- 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.

22.1.6 Product-related risk also encompasses the vulnerability of a product to use by a third party or to unintended use based on the methods of transactions available (ie service- and transaction-related risk). The following are examples of service and transaction attributes which may tend to increase the ML/TF risk profile:

- products with features or services which make it possible for customers to use the product in a way that is inconsistent with its purpose (for example, an insurance policy intended to provide long term investment opportunity but which allows frequent or low fee deposit / withdrawal transactions);
- customer is not the payer or recipient of the funds;
- products with features that allow loans to be taken against the policy (particularly if frequent loans can be taken and/or repaid with cash);
- acceptance to be used as collateral for a loan and/or written in a discretionary or other increased risk trust;
- payment source or recipient of funds are outside of the jurisdiction (eg insurer in jurisdiction A and payment source in jurisdiction B); and
- significant, unexpected, or unexplained change in customer's pattern of payment, withdrawal, or surrender.

22.1.7 Geographic-related risk refers to the risk that a market's or customer's geographic location or connections will enhance vulnerability to ML/TF. The following are examples of geographic attributes which may tend to increase the ML/TF risk profile:

- jurisdictions identified by credible sources as having weak governance, law enforcement and regulatory regimes,

including jurisdictions identified by FATF statements as having weak AML/CFT regimes;

- jurisdictions identified by credible sources as having significant levels of organised crime, corruption, or other criminal activity, including source or transit countries for illegal drugs, human trafficking, smuggling and illegal gambling; and
- jurisdictions subject to sanctions, embargoes, or similar measures issued by international organisations (such as the United Nations).

22.1.8 Customer-related risk refers to the risk that the insurer is doing business with a customer who is not adequately identified or may be involved with ML/TF. Customer-related risk factors include: customer identity; third-party involvement; customer source of wealth and funds; politically exposed customers; and known criminals or terrorists. The following are examples of customer attributes which may tend to increase the ML/TF risk profile:

- structure of a legal entity that is a customer, policyholder, or beneficiary obscures or makes it difficult to identify the ultimate beneficial owner or controlling interests;
- customer is reluctant to provide identification; exhibits difficulty producing identification; or provides identification documents of questionable authenticity;
- involvement of a gatekeeper or a third party apparently unrelated to the customer;
- higher risk business or occupation (such as those that are cash-intensive);
- mismatch between wealth and income of the customer and proposed premium amounts, deposit amounts or policy limits;
- customer is associated with negative news which may affiliate the customer with allegations of criminal behaviour; or has ties to or is on a designated sanctions list; and
- customer is considered a politically exposed person.

22.1.9 Delivery channel refers to the method offered to or used by a customer to start a new policy or account. Delivery channel-related risk refers to the vulnerability of the delivery channel to ML/TF based on attributes that may make it easier to obscure customer identity or the source of funds. The following are examples of delivery channel attributes which may tend to increase the ML/TF risk profile:

- non face-to-face sales without adequate safeguards for confirmation of identification or to mitigate the risks of identity fraud; and
- payments via intermediary that may obscure the source of payment (eg long chain of intermediaries).

Assessing ML/TF risks

22.1.10 The supervisor should assess the main ML/TF risks to the insurance sector in its jurisdiction. 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 assessments will change over time, depending on how circumstances develop, and how risks evolve. For this reason risk assessments should be undertaken on a regular basis and kept up to date.

22.1.11 The supervisor should consider the potential ML/TF risks alongside other risk assessments (for example, governance and market conduct) arising from its wider duties.

22.1.12 When a jurisdiction-wide risk assessment has been conducted (for example, during a National Risk Assessment (NRA) process as contemplated in FATF Recommendations, if applicable), the supervisor should have access to the results and take them into account. The supervisor should participate in such an assessment to inform the assessment and to improve its understanding of the risks.

22.2 The supervisor:

- **issues to insurers and/or intermediaries enforceable means on AML/CFT obligations consistent with the FATF Recommendations, for matters which are not in primary legislation;**
- **establishes guidance that will assist insurers and/or intermediaries to implement and comply with their respective AML/CFT requirements; and**
- **provides insurers and/or intermediaries with adequate and appropriate feedback to promote AML/CFT compliance.**

22.2.1 While the FATF Recommendations require the basic obligations of customer due diligence (CDD), record keeping and the reporting of suspicion to be set in primary legislation, the more detailed elements for technical compliance may be set in primary legislation or enforceable means (ie regulations, guidelines, instructions or other documents or mechanisms) that set out enforceable requirements in mandatory language with sanctions for non-compliance.

22.2.2 In some jurisdictions the supervisor, while an AML/CFT competent authority, may not be empowered to issue enforceable means; in that case the supervisor should cooperate and coordinate with the relevant authority holding such power.

22.2.3 The supervisor should require insurers and/or intermediaries to take appropriate steps to identify, assess and understand their ML/TF risks in relation to products (including services and transactions), geography, customers and delivery channels. The supervisor should also require insurers and intermediaries to manage and mitigate the ML/TF 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/TF risks. This may

be achieved by engaging with insurers and intermediaries and by providing information on supervision. For example, the supervisor may provide guidance on issues covered under the relevant FATF Recommendations (as implemented in primary legislation or enforceable means) including possible techniques and methods to combat ML/TF and any additional measures that insurers and/or intermediaries could take to ensure that their AML/CFT measures are effective. Such guidance may not necessarily be enforceable but will assist insurers and/or intermediaries to implement and comply with AML/CFT requirements.

22.2.5 Examples of appropriate feedback mechanisms used by the supervisor may include information on current ML/TF techniques, methods and trends (typologies), sanitised examples of actual ML/TF cases, 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 and resources made available by the FATF.

22.3 The supervisor has an effective supervisory framework to monitor and enforce compliance by insurers and/or intermediaries with AML/CFT requirements.

22.3.1 The supervisor should take into account the risk of ML/TF 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/TF. Staff of the supervisor should be appropriately skilled and provided with adequate and relevant training for assessing and combating ML/TF risks, including the necessary skills and knowledge to assess the quality and effectiveness of an insurer's and intermediary's AML/CFT systems and controls.

22.3.3 The supervisor should subject insurers and/or 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/TF risk profile of the insurer or intermediary.

22.3.4 The frequency and intensity of supervisory review should be based on:

- the ML/TF risks present in the jurisdiction including as identified in an NRA, if applicable, or other jurisdiction-wide risk assessment;
- the characteristics of insurers and/or intermediaries, in particular their number and diversity and the degree of discretion allowed to them under the RBA;
- the ML/TF risks and the policies, internal controls and procedures of each insurer and/or intermediary, as identified by the supervisor's assessment of their ML/TF risk profile; and

- the inherent and residual risks in relation to the particular insurer or intermediary based on the firm's own RBA of its ML/TF risks.

22.3.5 The supervisor should require insurers and/or intermediaries to undertake AML/CFT assessments on a regular basis, and to develop ML/TF risk profiles of their products (including services and transactions), geography, customers and delivery channels. The supervisor should require insurers and intermediaries to put in place risk management and control measures to effectively address identified risks.

22.3.6 The supervisor should have the power and resources to take proportionate, dissuasive and effective measures (including sanctions and other remedial and corrective measures) where insurers and intermediaries do not implement AML/CFT requirements effectively.

22.3.7 The supervisor should also require insurers and intermediaries to provide regular and timely training in AML/CFT to Board Members, Senior Management and other staff as appropriate, which is supported by a communication strategy which ensures that notification of significant changes in AML/CFT policies are regularly and timely provided.

22.4 The supervisor regularly reviews the effectiveness of the measures that insurers and/or intermediaries and the supervisor itself are taking on AML/CFT. The supervisor takes any necessary action to improve effectiveness.

22.4.1 Reviews should include regular assessment by the supervisor of the effectiveness of implementation by insurers and/or intermediaries of AML/CFT requirements and of its supervisory approach, including the extent to which the supervisor's actions have an effect on compliance by insurers and/or intermediaries.

22.4.2 These reviews may cover aspects such as:

- the ML/TF risks of a particular insurer and/or intermediary and whether these are adequately addressed by the firm's RBA;
- the adequacy of resources and training of both the supervisor and the insurance sector;
- whether AML/CFT off-site monitoring is adequate;
- whether the number and content of on-site inspections relating to AML/CFT measures is adequate;
- the findings of off-site monitoring and on-site inspections, including the effectiveness of training and implementation by insurers and intermediaries of AML/CFT measures;
- measures and sanctions taken by the supervisor against insurers and/or intermediaries;
- input from other AML/CFT authorities and the FIU on the insurance sector, such as the number and pattern of

suspicious transaction reports made by insurers and/or intermediaries;

- 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 insurance sector and feedback received from the insurance sector; and
- the number and type of ML/TF 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 of the AML/CFT measures being taken by insurers, and/or intermediaries and the supervisor itself.

22.4.3 The supervisor should maintain records on the frequency of off-site monitoring and number of on-site inspections relating to AML/CFT and on any measures it has taken or sanctions it has issued against insurers and/or intermediaries with regard to inadequate AML/CFT measures or non-compliance with AML/CFT requirements.

22.5 The supervisor has effective mechanisms in place which enable it to cooperate, coordinate and exchange information for AML/CFT purposes with other domestic authorities as well as with supervisors in other jurisdictions.

22.5.1 Effective prevention and mitigation of ML/TF is enhanced by close cooperation within a supervisor's organisation and among supervisors, the FIU, law enforcement agencies and other relevant authorities. Mechanisms of cooperation, coordination and exchange of information among relevant authorities should be documented and normally address:

- Operational cooperation and, where appropriate, coordination; and
- policy cooperation and, where appropriate, coordination.

22.5.2 Where the supervisor identifies suspected ML/TF in insurers or intermediaries, it should ensure that relevant information is provided in a timely manner to the FIU, any appropriate law enforcement agency and other relevant authorities.

22.5.3 The supervisor should take all necessary steps to cooperate, coordinate and exchange information with the other relevant authorities. The supervisor should communicate 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/TF risks to the insurance sector.

22.5.4 To promote an efficient exchange of information, the supervisor should consider identifying within its office a point of contact for AML/CFT issues and to liaise with other relevant authorities.

22.5.5 The exchange of information for AML/CFT purposes is subject to confidentiality considerations (see ICP 3 Information Sharing and Confidentiality Requirements).

Part B: ***Where the supervisor is not a designated AML/CFT competent authority***

22.6 The supervisor is aware of and has an understanding of ML/TF risks to which insurers and/or intermediaries are exposed. The supervisor liaises with and seeks to obtain information from the designated competent authority relating to AML/CFT by insurers and intermediaries.

22.6.1 The supervisor should have an understanding of the ML/TF risks to which insurers and/or intermediaries are exposed arising from activities undertaken in relation to products (including services and transactions), geography, customers and delivery channels, and the jurisdiction's approach to assessing and mitigating them.

22.6.2 To enhance such understanding, it is helpful if the supervisor has access to the NRA, if applicable, or other jurisdiction-wide risk assessment.

22.6.3 The supervisor should be able to make a more informed evaluation and judgment on the soundness of insurers and intermediaries by receiving information from the designated AML/CFT competent authority. Such information may be relevant to the risk profile of, or to the effectiveness of risk management by, an insurer or intermediary. The contents of this information may include the level of ML/TF risks to which insurers and/or intermediaries are exposed, and the designated competent authority's views on the corporate governance, risk management and internal control measures of supervised entities relevant to AML/CFT.

22.6.4 The designated AML/CFT 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 suitability of the Board, Senior Management and Key Persons in Control Functions, including when reviewing licence applications.

22.7 The supervisor has effective mechanisms in place which enable it to cooperate, coordinate and exchange information for AML/CFT purposes with relevant domestic authorities as well as with supervisors in other jurisdictions.

22.7.1 Effective prevention and mitigation of ML/TF is enhanced by close cooperation within a supervisor's organisation and among supervisors, the FIU, law enforcement agencies and other relevant authorities. Mechanisms of cooperation, coordination and exchange of information among relevant authorities should be documented and normally address operational cooperation and, where appropriate, coordination.

22.7.2 When the supervisor becomes aware of information on ML/TF risks, it should provide relevant information to the designated AML/CFT competent authority. When the supervisor identifies suspected ML/TF in insurers and/or intermediaries, it should ensure that relevant information is provided to the FIU, appropriate law enforcement agencies and any relevant supervisors.

22.7.3 As part of its cooperation with the designated AML/CFT 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 the framework's effectiveness.

22.7.4 The exchange of information for AML/CFT purposes is subject to confidentiality considerations (see ICP 3 Information Sharing and Confidentiality Requirements).

ICP 23 Group-wide Supervision

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.

CF 23.0.a The group-wide supervisor, in cooperation with other involved supervisors, determines whether an insurance group or an insurance legal entity operating through branches, is an IAIG after considering whether it meets both the following criteria:

- **Internationally active:**
  - **Premiums are written in three or more jurisdictions; and**
  - **Gross written premiums outside of the home jurisdiction are at least 10% of the group's total gross written premiums.**
- **Size (based on a three-year rolling average):**

- **Total assets are at least USD 50 billion, or**
- **Total gross written premiums are at least USD 10 billion.**

CF 23.0.a.1 The criteria should be assessed based on the insurance group's reported financial statements, either on a consolidated basis when available or as otherwise submitted to the group-wide supervisor. Intra-group transactions should be eliminated when calculating the amount of insurance business written in each jurisdiction and total insurance business written, and when calculating the total assets of the group.

CF 23.0.a.2 "Total assets" are, at least, group assets related to the insurance business of the group.

CF 23.0.a.3 "Gross written premiums" represent a measure of the volume of insurance business being written. Where alternative but similar volume measures are required under the accounting framework applicable to the group, then these alternative measures may be used as a more practical way of deciding if a group meets the criterion for an IAIG. An example of an alternative measure may be "premiums received" as required for disclosure purposes under International Financial Reporting Standard 17.

CF 23.0.a.4 Although an insurance legal entity that has no parent or subsidiaries is not an insurance group, it should be regarded as an IAIG if it operates on a branch basis in foreign jurisdictions and meets the criteria. The supervisor of this entity, in cooperation with other involved supervisors, would determine whether the IAIG criteria are met. References to a 'group' in this context would include such entities operating through branches which are identified as IAIGs.

CF 23.0.a.5 For the purposes of assessing groups against the internationally active criterion, the United States of America should be regarded as a single jurisdiction and member states of the European Union should be regarded as separate jurisdictions.

CF 23.0.a.6 Any involved supervisor may prompt the process of identifying an IAIG. If no group-wide supervisor has been determined, the supervisor most demonstrating the characteristics of a group-wide supervisor should invite involved supervisors to participate in the process of determining whether a group is an IAIG.

CF 23.0.a.7 The scope of an insurance group should be determined before considering whether the criteria for determining whether the group is an IAIG are met.

CF 23.0.a.8 If there is already a supervisory college for a group, it should be used to facilitate the determination as to whether the group is an IAIG.

CF 23.0.b In limited circumstances the group-wide supervisor has discretion to determine that a group is not an IAIG even if it meets the criteria or that a group is an IAIG even if it does not meet the criteria.

CF 23.0.b.1 If discretion has been used, then the reasons for exercising such discretion should be based on verifiable and documented quantitative and qualitative information.

CF 23.0.b.2 Examples of situations where a group-wide supervisor may exercise discretion to determine that a group is an IAIG despite not meeting all the criteria are where:

- an other involved supervisor requests that the group be treated as an IAIG owing to the materiality of the operations in its jurisdiction;
- the group is expected to meet the criteria in the near future owing to mergers or acquisitions;
- the group's international activity or size have decreased owing to some temporary or transitory effect such as an economic shock or exchange rate fluctuations and it would not be reasonable to alter the group's identification as an IAIG for a short period;
- the group has related entities which are not included in the consolidated financial statements, but which are relevant to the risks of the group;
- the group has significant off-balance sheet assets (such as funds under management held on behalf of investors) which arise from insurance operations and so are more appropriately included in the total assets when assessing the group against the size criterion;
- the group changes or rearranges its business activities to avoid meeting the IAIG criteria including by splitting the insurance business into multiple sub-groups with separate operational controllers.

CF 23.0.b.3 Examples of situations where a group-wide supervisor may exercise discretion to determine that a group is not an IAIG despite meeting the criteria are where:

- the group will cease to meet the criteria in the near future owing to, for example, disposals of some or all of its insurance business;
- the group's international activity or size have increased owing to some temporary or transitory effect such as an economic shock or exchange rate fluctuations and it would be unreasonable to identify the group as an IAIG for a short period; and
- the group's business outside of the home jurisdiction exceeds 10% in aggregate but its business in any one jurisdiction outside the home jurisdiction is negligible.

CF 23.0.c The group-wide supervisor notifies the group of its decision to identify it as an IAIG and reasons for that decision.

CF 23.0.d **The group-wide supervisor, in cooperation with other involved supervisors, regularly reviews previously made determinations concerning whether a group is an IAIG.**

CF 23.0.d.1 Such reviews should take place at least once every three years.

CF 23.0.d.2 An ad hoc assessment should take place in circumstance where a significant change or event may impact the identification of a group as an IAIG.

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.

23.1.2 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.

23.1.3 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; or
- 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.

23.1.4 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.

23.1.5 The ICPs' definition of "insurance group" may be different from the definitions used in other contexts, such as accounting or tax purposes.

CF 23.1.a The group-wide supervisor identifies the Head of the IAIG as the legal entity which controls all of the insurance legal entities within the group and non-insurance legal entities which pose risk to the insurance operations.

CF 23.1.b When identifying the Head of the IAIG, the group-wide supervisor considers both control as defined in ICP 6 (Changes in control and portfolio transfers) and operational control.

CF 23.1.b.1 Operational control means the ability in practice, whether or not a legal right exists, to do some or all of the following:

- select, appoint, or remove Board Members of related entities;
- determine remuneration of Board Members of related entities;
- set or influence capital expenditure and investment plans;
- set a dividend strategy and levels of surplus capital to be retained;
- determine new lines of business to be undertaken;
- set risk management policies and processes; and
- require reporting of management information.

CF 23.1.c When identifying the Head of the IAIG, if there is more than one entity which controls all of the insurance legal entities, the group-wide supervisor determines the Head of the IAIG to be the entity that exercises the greatest level of control over all the insurance legal entities by considering the following factors:

- **the proportion of the insurance business relative to other businesses it controls;**
- **the degree of operational control; and**
- **the degree of shareholder control.**

CF 23.1.c.1 Considering the above factors is particularly relevant when an IAIG has a vertical structure with several intermediate holding companies,

is a financial or industrial conglomerate, or has several insurance sub-groups.

CF 23.1.c.2 Consideration of which entity controls the greatest proportion of insurance business relative to other business may lead the group-wide supervisor to determine that the Head of the IAIG is an intermediate holding company rather than the ultimate parent of the group.

CF 23.1.c.3 Consideration of where operational control is greatest may lead the group-wide supervisor to determine that the Head of the IAIG is an intermediate holding company rather than the ultimate parent of the group. It may also lead the group-wide supervisor to determine that one insurance legal entity is the Head of the IAIG by virtue of its operational control over another insurance legal entity even where it does not own that entity.

CF 23.1.c.4 Consideration of where shareholder control is greatest may lead the group-wide supervisor to determine that the ultimate parent in a conglomerate is the Head of the IAIG rather than an intermediate holding company.

CF 23.1.d The group-wide supervisor considers that a non-insurance legal entity within the group poses risk to the insurance operations where there is:

- **a linkage between the insurance operations and the non-insurance legal entity (other than an investment in or from the non-insurance legal entities) that could adversely affect the insurance operations; and**
- **a lack of adequate safeguards, including additional capital, to mitigate risks arising from any such linkages.**

CF 23.1.d.1 Consideration of the control exerted over non-insurance legal entities within the group may lead the group-wide supervisor to determine that the Head of the IAIG is the ultimate parent of the group rather than an intermediate holding company.

CF 23.1.d.2 A parent of the insurance legal entities is less likely to pose a risk to the insurance operations if the only linkage between it and the insurance legal entities is of the nature of a passive investment and so no operational control is being exerted.

CF 23.1.d.3 The group-wide supervisor should be able to require preventive or corrective measures at the same level at which all the risks to insurance operations in the group (including funding risks) are mitigated by capital.

CF 23.1.e Where a legal entity controls all insurance legal entities within the group and non-insurance legal entities which pose risks to the insurance operations, the group-wide supervisor has discretion to identify a subsidiary of that entity as the Head of the IAIG if:

- **prudential supervision is exercised by another financial sector supervisor over that entity; and**
- **the group-wide supervisor can rely on the other financial sector supervisor to provide sufficient information concerning**

risk that this entity and the legal entities it controls pose to the insurance operations.

CF 23.1.e.1 The Head of an IAIG should not be a bank when:

- that bank is subject to prudential supervision exercised by another financial supervisor; and
- the group-wide supervisor is able to rely on this other financial sector supervisor to obtain information on the wider group and to ensure that the group is adequately capitalised.

CF 23.1.e.2 If this precludes there being a single Head of the IAIG which controls all the insurance legal entities, then the group may be supervised as two or more separate IAIGs even if separately those IAIGs would not meet the size and international activity criteria.

CF 23.1.f The group-wide supervisor provides the supervisory college with the main reasons and judgements it made when identifying the Head of the IAIG.

CF 23.1.f.1 As the supervisory college may qualify as a crisis management group for the IAIG (IAIG CMG), when identifying the Head of the IAIG, the group-wide supervisor should understand where resolution powers are applicable. The Head of the IAIG identified for prudential supervision purposes may not be the same as the entity at the level of which resolution powers will apply.

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.

23.2.2 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.

23.2.3 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.

23.2.4 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.

23.2.5 The exclusion or inclusion of entities within the scope of group-wide supervision should be regularly re-assessed.

23.2.6 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.

CF 23.2.a **In conducting group-wide supervision, the group-wide supervisor obtains information necessary to apply standards to the Head of the IAIG concerning all the legal entities controlled by the Head of the IAIG (the IAIG) including from:**

- **the Head of the IAIG;**
- **with the cooperation of other involved supervisors, insurance legal entities controlled by the Head of the IAIG; and**
- **other non-insurance legal entities, whether or not controlled by the Head of the IAIG.**

The group-wide supervisor decides from which legal entities information should be sought.

CF 23.2.a.1 The group-wide supervisor may need to obtain information about related group entities, such as:

- any intermediate holding company or ultimate parent of the Head of the IAIG;
- any significant owner of the IAIG;
- any person exerting significant influence over the IAIG;
- any financial entity which is subject to supervision by an authority other than an insurance supervisor; or
- entities excluded from the consolidated data used to assess group solvency.

CF 23.2.a.2 Where there are entities related to the Head of the IAIG from which information is necessary for supervisory purposes, then the group-wide supervisor should obtain that information from those entities or from other sources, for example:

- the Head of the IAIG (insofar as the Head of the IAIG can legally procure that information);
- any supervisor of a related non-insurance financial entity; or
- the members of the Board, Senior Management and Key Persons in Control Functions involved in the insurance business, irrespective of the entity employing those persons.

CF 23.2.a.3 The group-wide supervisor should understand how risks in non-regulated related group entities affect, for example, the risk management and capital adequacy of the IAIG. However this does not require the group-wide supervisor to supervise directly such entities.

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

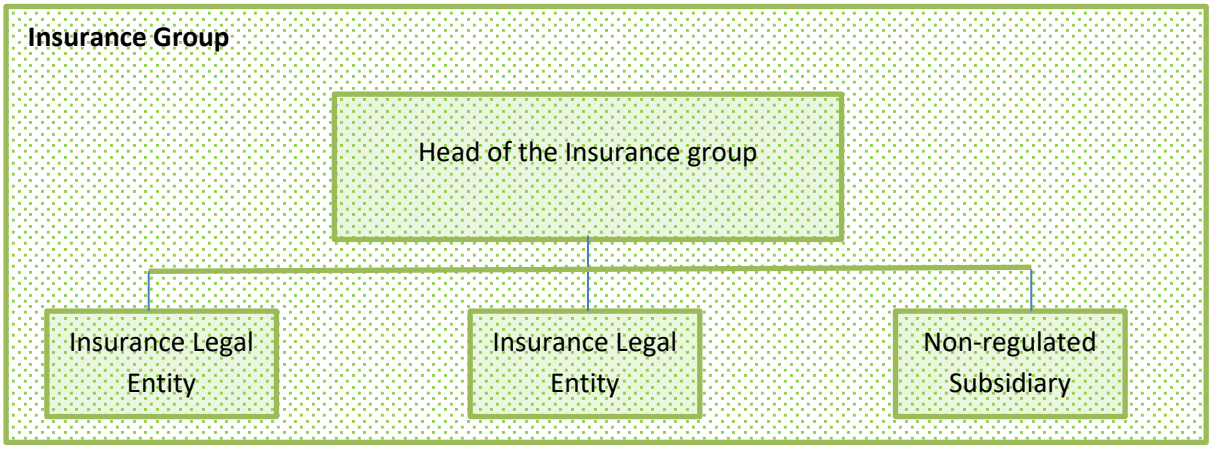


Figure 23.2 Financial Conglomerate

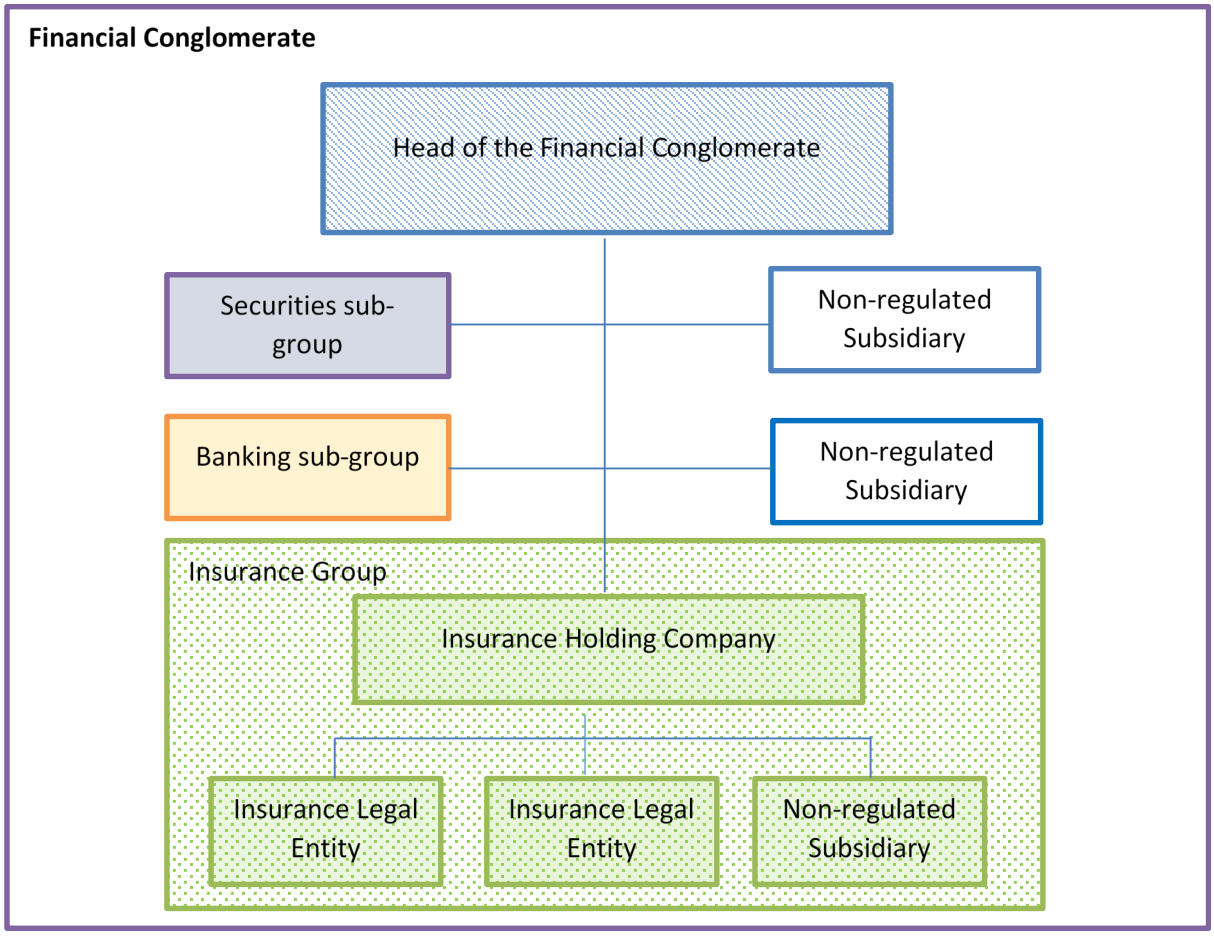


Figure 23.3 Insurance-led Financial Conglomerate

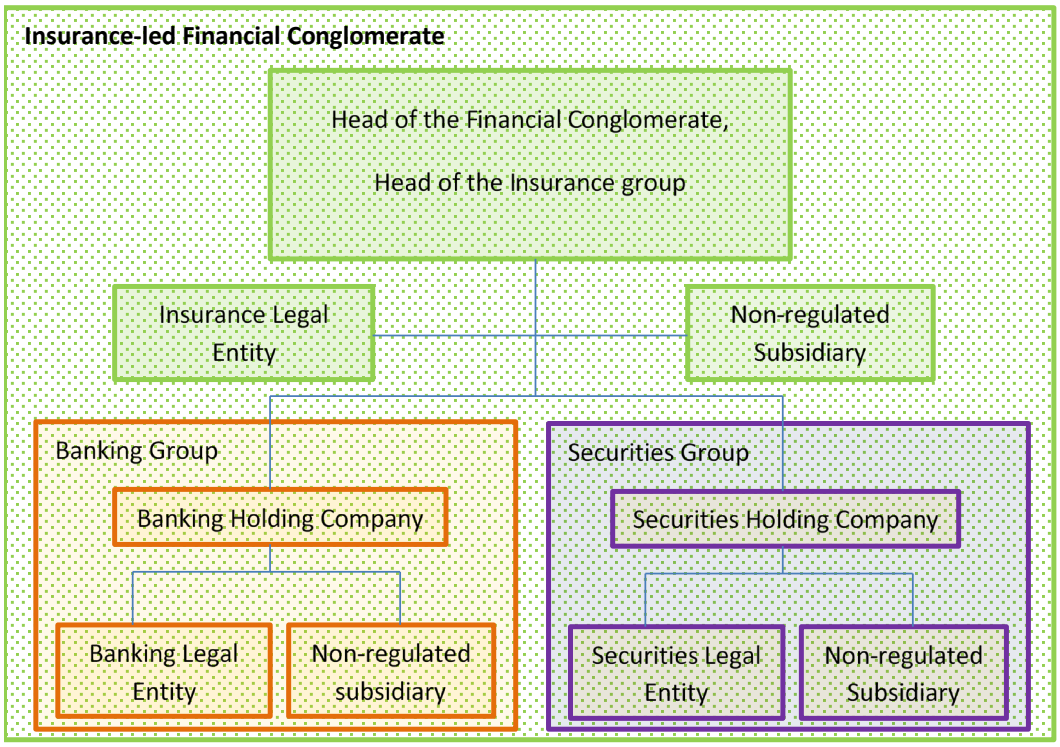
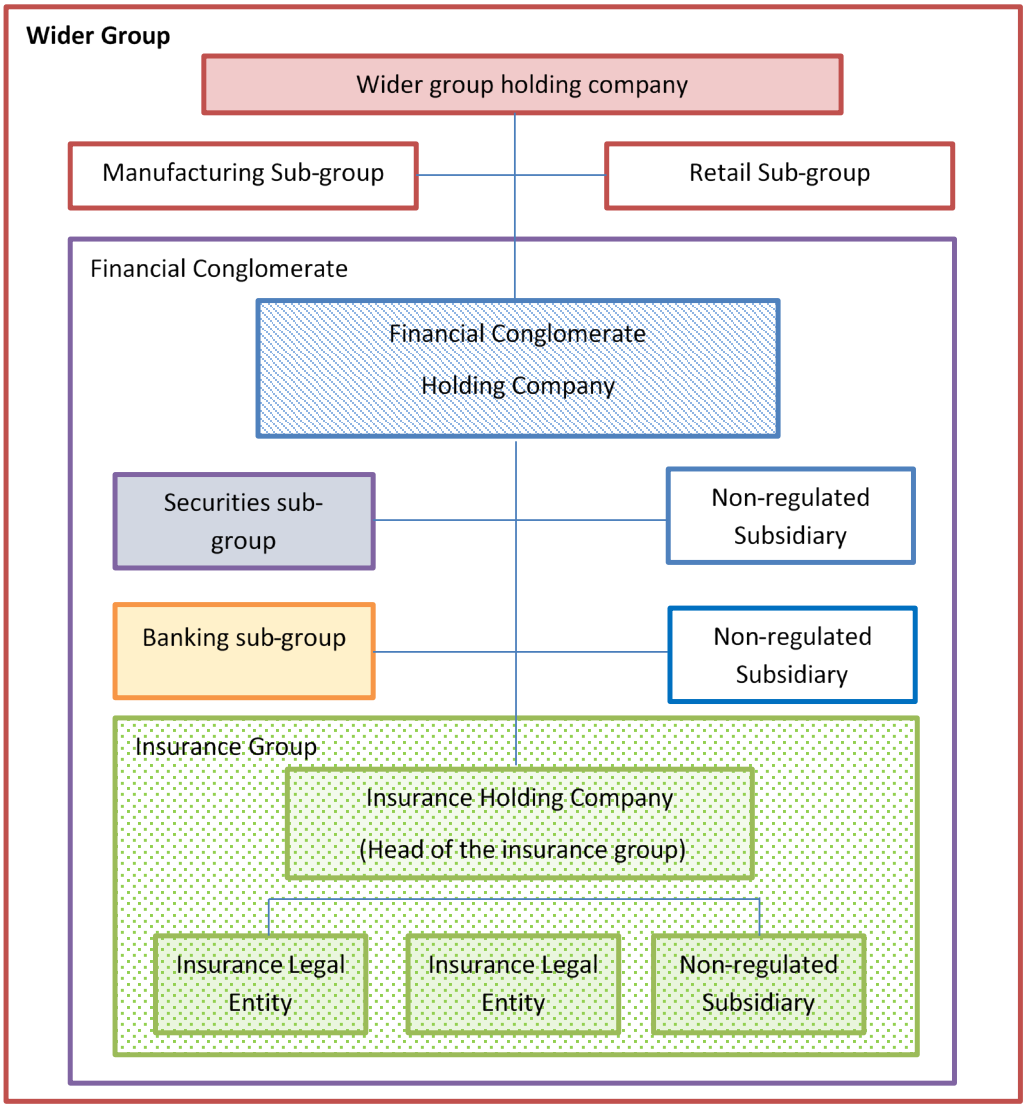


Figure 23.4 Wider group



ICP 24 Macroprudential Supervision

The supervisor identifies, monitors and analyses market and financial developments and other environmental factors that may impact insurers and the insurance sector, uses this information to identify vulnerabilities and address, where necessary, the build-up and transmission of systemic risk at the individual insurer and at the sector-wide level.

Introductory guidance

24.0.1 This ICP focuses on the general processes and procedures supervisors should have in place with respect to macroprudential supervision, as part of the overall supervisory framework (see ICP 9 Supervisory Review and Reporting). A jurisdiction's macroprudential supervision processes and procedures should be proportionate to the nature, scale and complexity of its insurance sector's exposures and activities.

24.0.2 Macroprudential supervision consists of data collection, market and trend analysis, systemic risk assessment, supervisory response and transparency. It identifies and, where necessary, addresses both vulnerabilities of individual insurers and the insurance sector to shocks (inward risks) and the build-up of systemic risk at the individual insurer level or the sector as a whole (outward risks). Inward risks include insurance and financial market developments, which may impact the insurance sector. Outward risks refer to the risks that individual insurers or the insurance sector may pose to the financial system and the real economy. Macroprudential supervision contributes to financial stability by minimising the incidence and impact of externalities on the financial system and real economy generated or amplified through the distress or default of individual insurers or common behaviours.

24.0.3 Macroprudential supervision involves the identification, monitoring and assessment of:

- sector-wide vulnerabilities and common exposures in the insurance sector; and
- the risk of amplification and transmission of shocks to the financial system and real economy caused by:
    - the size, complexity, lack of substitutability and/or interconnectedness of a distressed or failing insurer; or
    - collective actions or distress of a sufficiently large number of insurers undertaking similar activities and thus exposed to common risks.

24.0.4 Systemic risk may be defined as the risk of disruption to financial services that is caused by an impairment of all or parts of the financial system and has the potential to have serious negative consequences for the real economy. Systemic impact may originate from individual or sector-wide exposures to liquidity risk, interconnectedness (macroeconomic and counterparty exposure) or lack of substitutability as well as from other

risks. These risks may spread to other parts of the financial system via asset liquidation, exposures or critical functions.

24.0.5 Macroprudential supervision can help identify the need for supervisory measures. In its macroprudential supervision, the supervisor should also take into account the material risks that non-insurance legal entities and activities may pose to insurance legal entities, insurance groups and the wider financial system.

24.0.6 The supervisory framework should allow the supervisor to respond in a timely manner to findings from the analysis performed as part of its macroprudential supervision.

Data collection for macroprudential purposes

24.1 The supervisor collects data necessary for its macroprudential supervision.

24.1.1 Data collection for macroprudential purposes should take into account the following general aspects:

- Efficiency of data collection: the supervisor should examine costs and benefits when considering data collection. Data collections should be aligned with their respective usage. The supervisor should first make use of all available data sources and then calibrate its data requests and data processing capabilities;
- Data validation: before analysing data and providing recommendations on the findings, the supervisor should validate data used in its assessment;
- Data quality assurance: the supervisor should regularly evaluate the appropriateness of data collected and data needs to capture market developments and address deficiencies in:
    - the type of data collected;
    - its ability to process data in a timely and/or complete way; and
    - its ability to collect ad hoc data in a timely manner.
- Scope: for sector-wide assessments, data collection should cover a representative sample of the respective market or risk;
- Consistency: regular data collections of a standardised set of information should remain consistent over time in order to analyse trends. The supervisor should, however, consider the evolving nature of the relevant exposures; and
- Ad hoc data collection: in order to address emerging risks, the supervisor should have processes in place that allow for ad hoc data collections.

24.1.2 To support the assessment of liquidity risk, the supervisor should collect data that provide sufficient indications on possible liquidity mismatch between assets and liabilities both at individual and sector-wide level. Reporting requirements on liabilities should include, but not be limited to, information on the surrender value of insurance products, product features that increase or decrease the propensity for early pay outs under certain circumstances (such as penalties or delays in the ability to access

the cash value of a policy), and the maturity or redemption structure of non-insurance liabilities. On the asset side information on the degree of liquidity of the assets and on the potential margin call on derivatives should be collected.

24.1.3 To support the assessment of macroeconomic exposure, the supervisor should collect data that is sufficiently granular to enable an analysis of an insurer's, as well as the insurance sector's vulnerability to macroeconomic shocks (such as sensitivity to interest rate movements) and general market movements (such as sensitivity to equities and fixed income asset movements).

24.1.4 To support the assessment of counterparty risk, the supervisor should collect data that includes the concentration of the assets and liabilities, with regard to counterparties, markets (such as equity or debt), sectors (such as financial or real estate), and geographical areas.

24.1.5 The supervisor should collect microeconomic data, such as insurance pricing, underwriting, expenses, claims inflation, reinsurance, intra-group transactions, and general developments in the insurance sector (for example, the development of claims, earned and guaranteed interest rates, reserves, pandemics, and changes in morbidity and mortality, longevity, changes in the frequency and severity of catastrophes changes in medical expense inflation and changes in law). In addition, the supervisor may collect data on both the asset and the liability structure of insurers, including those that are related to non-insurance activities. The supervisor should consider having established processes and communication channels on microeconomic data collection with other involved supervisors when an insurer operates in multiple jurisdictions.

24.1.6 The supervisor should collect macroeconomic data to complement information mainly gathered as a result of supervisory reporting. Data may include general domestic and international macroeconomic variables (such as interest rates, exchange rates, inflation or balance of payments, as well as data on market structure and competitiveness) which could identify macroeconomic instabilities and sources of risk both in the domestic and the global economy. Macroeconomic data may be used to assess the exposure of insurers' portfolios of both assets and liabilities to economy-wide factors. For insurers operating in multiple jurisdictions, the supervisor should consider collecting relevant macroeconomic data for material jurisdictions.

Insurance sector analysis

24.2 The supervisor, as part of its macroprudential supervision, performs analysis of financial markets and the insurance sector that:

- **is both quantitative and qualitative;**
- **considers historical trends as well as the current risk environment; and**
- **considers both inward and outward risks.**

24.2.1 To enable macroprudential supervision, the supervisor should have processes and procedures in place that would allow for analysis on insurance sector trends that could potentially result in externalities to the

wider financial system and/or adversely impact the insurance sector. These trends include changes in economic conditions and technology, as well as environmental, social and governance developments. Such processes and procedures should also recognise that changes in the exposures of insurers can potentially have macroprudential risk implications.

Quantitative and qualitative analysis

24.2.2 Quantitative analysis includes identifying trends, outliers, interconnectedness and/or risk concentrations of existing or newly identified vulnerabilities. Typical methods of quantitative analysis may include

- horizontal reviews;
- descriptive statistics;
- trend analysis; and
- statistical modelling using past data.

24.2.3 Qualitative analysis includes performing assessments based on judgment, experience, information and any other factors that either cannot be measured or quantified with typical methods. Qualitative analysis may be particularly relevant for the assessment of low probability high impact type of events with limited quantifiable data available.

24.2.4 The supervisor should conduct horizontal reviews to reveal the range of practices among insurers relevant to a common subject (for example, the assessment of the appropriateness of insurers' assumptions used for reserving). A horizontal review may help to determine which insurers are outliers, and as such provides the supervisor with a reference for potential further actions. A horizontal review may provide an aggregated view of the risks linked to certain exposures and/or activities and may also help determine whether industry practice as a whole is effective enough to address the risks embedded in the activity.

24.2.5 To make horizontal reviews effective, the following may be taken into account:

- where peer groups are used, the choice of the peer group can have an impact on the outcome of the review. The supervisor should carefully consider the criteria for including insurers in a peer group;
- when reviewing an insurer operating in multiple jurisdictions, the group-wide supervisor should form a group-wide perspective. Such a perspective can build on analyses performed by a peer authority or a third party (including international organisations such as the IAIS, IMF and World Bank);
- the results of horizontal reviews performed within a single jurisdiction can be beneficial to the supervisory community as a whole, especially as they may relate to systemic risk to the insurance sector. The supervisor may also consider suitable fora for the communication of information that is not necessarily insurance or insurer specific; and

- horizontal reviews need not always be complex exercises. 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, may help the supervisor to identify areas of potential risk and help it to target future work.

Historic trends and current risk environment

24.2.6 The supervisor should have in place an appropriate form of stress testing, which is applied to the insurance sector as a whole or to a significant sub-sample of insurers, selected according to the exposures to specific risks to be assessed. Outcomes of insurance sector and financial market analysis should be considered in the development of severe but still plausible scenarios to be tested in such exercises. Scenarios should reflect the current market environment and potential unfavourable evolutions in terms of changes in markets and insurance specific risk exposures. In order to contextualise the results, the supervisor should take into account the characteristics of the supervisory framework and the structure of the insurer's assets and liabilities. Following a stress test exercise, the supervisor should discuss potential vulnerabilities and potential mitigating actions with the relevant insurers.

24.2.7 While many data items are backward looking, insurance sector analysis should be forward looking, to the extent possible, when developing scenarios to capture potential future developments. Stress scenarios should take into account ways that market dynamics have changed, which may make historical data less relevant.

24.2.8 The supervisor should use stress tests to identify vulnerabilities and risks and assess the impacts to the insurance sector and for individual insurers. Additionally, stress scenarios should be used to identify how those potential impacts may spread.

Inward and outward risks

24.2.9 When assessing both inward and outward risks, the supervisor should assess insurers' exposures to liquidity risk, interconnectedness (macroeconomic and counterparty exposure), lack of substitutability and other risks. Assessing inward risks refers to the extent insurers may be exposed to, or vulnerable to, a certain risk within the insurance sector, whereas the outward risk refers to the situation in which these vulnerabilities would generate externalities which may then propagate to other financial markets or the real economy.

24.2.10 The supervisor should monitor the liquidity of an insurer's invested assets relative to its insurance liabilities based on their characteristics. Additionally, the supervisor should analyse the potential that a large insurer's operations could require it, or a sufficiently large number of insurers, to engage in asset sales of a significant size. The supervisor should assess the funding structure of insurers and their reliance on short term funding.

24.2.11 The supervisor should monitor interconnectedness with the financial system (for example, via intra-financial assets and liabilities or derivatives). As these exposures can be on a cross-jurisdictional and

cross-sectoral basis, the supervisor should cooperate with supervisors in other relevant jurisdictions and sectors.

24.2.12 Macroeconomic exposure in insurance liabilities depends on the characteristics of applicable investment guarantees as well as other contractual provisions and the complexity of the underlying risks. Monitoring of macroeconomic exposure should recognise the relationship between the assets and liabilities of the insurer. Stress tests can be used to support monitoring of this exposure.

Assessing systemic importance

24.3 The supervisor has an established process to assess the potential systemic importance of individual insurers and the insurance sector.

24.3.1 The supervisor should take a total balance sheet approach (see ICP 16 Enterprise Risk Management for Solvency Purposes) when considering the potential systemic importance of an insurer. When analysing systemic risk stemming from the insurance sector, the supervisor should at least consider common exposures and activities.

24.3.2 The supervisor should consider the type of policies underwritten by insurers and the activities insurers are engaged in, such as the degree of engagement in derivatives activity and reliance on short-term market activity. The supervisor should also consider the interconnectedness with other financial institutions, and the role of the insurance sector within the broader financial system.

24.3.3 As part of its assessment, the supervisor should consider emerging developments that may affect the insurance sector's risk exposures. Additionally, the supervisor should cooperate and coordinate with other financial sector supervisors (such as banking, securities and pension supervisors, central banks and government ministries) to gain additional perspectives on the potential change in the risk exposures of insurers stemming from evolutions of other markets.

24.3.4 The supervisor should communicate the findings of its assessment as appropriate, to either individual insurers or the sector. The supervisor should require insurers to take action necessary to mitigate any particular vulnerabilities that have the potential to pose a threat to financial stability.

Supervisory response

24.4 The supervisor uses the results of its macroprudential supervision, and considers the potential systemic importance of insurers and the insurance sector, when developing and applying supervisory requirements.

24.4.1 A macroprudential perspective in the development and application of supervisory requirements may help limit the build-up of systemic risks and contribute to the resilience of the financial system. The supervisor should ensure that there is an appropriate interaction between its macroprudential analysis and assessment activities, on the one hand, and microprudential supervision, on the other hand.

24.4.2 As part of introducing supervisory requirements into its supervisory framework, the supervisor should consider implementing supervisory measures based on macroprudential concerns. Many macroprudential tools are, in effect, microprudential instruments developed or applied with

a macroprudential perspective in mind. By mitigating risk exposures, some measures that are intended to protect policyholders may also contribute to financial stability by decreasing the probability and magnitude of any negative systemic impact.

24.4.3 The supervisor should determine the depth and level of supervision based on its assessment of the systemic importance of individual insurers or the insurance sector (see ICP 9 Supervisory Review and Reporting). The supervisor should act to reduce systemic risk when identified within its jurisdiction through an appropriate supervisory response. In jurisdictions where one or more insurers have been assessed as systemically important, or a number of insurers are contributing to systemic risk, the supervisor should have supervisory requirements targeted at those insurers to mitigate systemic risk. The supervisor should extend certain requirements as necessary to an insurer and/or a number of insurers that it has assessed to be systemically important.

24.4.4 Specific supervisory responses may relate to:

- requirements on insurers:
  - enterprise risk management (see ICP 16 Enterprise Risk Management for Solvency Purposes);
  - disclosures (see ICP 20 Public Disclosure);
- preventive or corrective measures (see ICP 10 Preventive Measures, Corrective Measures and Sanctions); and
- crisis management and planning:
  - crisis management, including crisis management groups (see ICP 25 Supervisory Cooperation and Coordination); and
  - recovery and resolution planning (see ICP 12 Exit from the Market and Resolution and ICP 16 Enterprise Risk Management for Solvency Purposes).

24.4.5 Supervisory requirements may be intended to mitigate the potential spill-over effects from the distress or disorderly failure of an individual insurer or from the common exposures or behaviours of a group of insurers or across the sector. In the latter case, supervisory requirements may have different effects during different phases of the economic, underwriting or credit cycle. Therefore, the supervisor may develop requirements that are time-varying in nature, depending on the economic environment. The activation of such time-varying requirements could be rules-based (for example triggered automatically given a pre-defined condition) or discretionary (ie upon explicit decision by the supervisor). A rules-based approach may be more transparent but requires regular assessments of its adequacy under changing conditions affecting the insurance business.

Transparency

24.5 The supervisor publishes relevant data and statistics on the insurance sector.

24.5.1 The publication of data and statistics by the supervisor may enhance market efficiency by allowing market participants to make more informed

decisions and reducing the cost to the public of acquiring insurance sector information. Moreover, the publication of data may serve as a market disciplining mechanism by facilitating comparisons of an individual insurer to the sector as a whole.

24.5.2 The supervisor may provide access to sufficiently detailed data either by publishing data itself or by providing others with adequate means for publishing data. This could be achieved by engaging a government statistical office or cooperating with the local insurance sector; provided the supervisor is satisfied with the accuracy, completeness, frequency and timeliness of such publication.

ICP 25 Supervisory Cooperation and Coordination

The supervisor cooperates and coordinates with involved supervisors and relevant authorities to ensure effective supervision of insurers operating on a cross-border basis.

Introductory Guidance

25.0.1 Supervisors of the different insurance legal entities within an insurance group with cross-border activities should coordinate and cooperate in the supervision of the insurance group as a whole. Supervisors of different insurance legal entities which are not part of the same group may also need to cooperate and coordinate particularly where the insurers are connected through reinsurance treaties or when difficulties in one insurer may affect the market more generally, such as in resolution situations (see ICP 12 Exit from the Market and Resolution).

25.0.2 Supervisors may draw upon several supervisory practices to facilitate cross-border cooperation and coordination. These practices include the identification of a group-wide supervisor and the use of coordination arrangements, including supervisory colleges.

25.0.3 The group-wide supervisor is one of the involved supervisors and is chosen to lead group-wide supervision of an insurance group. The group-wide supervisor should facilitate and lead the cooperation and coordination between the other involved supervisors and engage them in the relevant supervisory decisions regarding the insurance group. The group-wide supervisor is ultimately responsible for delivering effective and efficient group-wide supervision. The other involved supervisors should provide the group-wide supervisor with information regarding insurance legal entities they supervise and otherwise participate in group-wide supervision. The procedures for systematic or ad hoc information exchange should be agreed with the other involved supervisors. The sharing of information by the group-wide supervisor and the other involved supervisors should be subject to confidentiality requirements (see ICP 3 Information Sharing and Confidentiality Requirements).

25.0.4 The undertaking of cooperation and coordination should not be taken to imply joint decision making authority or any delegation of an individual supervisor's responsibilities. Supervisory decisions remain within the responsibility of each of the involved supervisors.

Supervisory Recognition

25.0.5 Supervisors wishing to determine whether they can recognise and rely upon another supervisory regime for the purpose of group-wide supervision and designation of supervisory tasks should carry out an assessment of the acceptability of the counterpart's regime reflecting the level or objective of supervisory recognition sought. Supervisors may use different processes to conduct a supervisory recognition assessment. The form of recognition and the criteria used for assessment will vary depending on its purpose.

25.0.6 When the assessment has been finalised, the decision as to whether to recognise the supervisor should be communicated to the subject of the assessment. If recognition is not possible, the areas where the criteria were not met should be communicated and the supervisors should discuss how recognition may be achieved in future. A process for reassessment could then be established.

25.0.7 Following recognition, the supervisor should periodically assess whether a recognised supervisor continues to meet the criteria for recognition.

25.0.8 The terms of supervisory recognition, as well as specific roles and responsibilities, may be set out in unilateral statements, bilateral agreements, or multilateral agreements.

25.1 The supervisor discusses and agrees with the involved supervisors which of them is the group-wide supervisor for cross-border insurance groups operating in its jurisdiction.

25.1.1 In principle, the home supervisor of the head of the insurance group should be considered first to take the role of the group-wide supervisor in accordance with its authority and powers in its jurisdiction. In some jurisdictions, the legal or regulatory system may include provisions which allow or require the designation of a group-wide supervisor.

25.1.2 In case a different or several involved supervisors fulfil the conditions to be considered as a group-wide supervisor, factors to consider regarding the identification of a group-wide supervisor should include:

- the location of the insurance group's head office, given that this is where the group's Board and Senior Management is most likely to meet;
- where the registered head office is not the operational head of the insurance group, the location where:
  - the main business activities are undertaken;
  - the main business decisions are taken;
  - the main risks are underwritten; and/or
  - the largest balance sheet total is located; and
- the involved supervisors' resources, skills, authorities and powers in their jurisdictions.

CF 25.1.a.1 When determining the group-wide supervisor of an IAIG, the involved supervisors should consider which supervisor would have direct powers over the Head of the IAIG (see ComFrame material under ICP 10 Preventive Measures, Corrective Measures and Sanctions).

25.2 As a group-wide supervisor, the supervisor:

- **understands the structure and operations of the insurance group; and**
- **leads group-wide supervision, taking into account assessments made by the other involved supervisors.**

Overall responsibilities of a group-wide supervisor

25.2.1 Once identified, the group-wide supervisor should be responsible for coordinating the input of insurance legal entity supervisors in undertaking group-wide supervision as a supplement to the existing insurance legal entity supervision.

25.2.2 Responsibilities of the group-wide supervisor should include:

- chairing of the supervisory college (where one exists), or consider establishing one if not in place yet;
- determination of the scope of group supervision;
- leadership, planning and coordination of group-wide supervisory activities;
- aggregation of group-wide information and dissemination of the relevant information to the other involved supervisors;
- preparation and discussion of group-wide supervisory analysis;
- performing a group-wide supervisory assessment, including assessing group capital management, risk and solvency, risk concentration, intragroup transactions and group governance;
- coordination of information sharing procedures amongst other involved supervisors;
- decision making on group-wide issues in consultation with other involved supervisors, where relevant;
- implementation and coordination of decisions on group-wide issues including preventive and corrective measures and sanctions; and
- identification of gaps in supervision.

25.2.3 The group-wide supervisor should take the initiative in coordinating the roles and responsibilities of, and facilitating communication between, the other involved supervisors. In carrying out its agreed functions, the group-wide supervisor should strive to act with the consensus of the other involved supervisors.

Information sharing and key contact point function

25.2.4 The group-wide supervisor should request information from other involved supervisors needed to fulfil its role.

25.2.5 The group-wide supervisor should make relevant information available to the other involved supervisors on a proactive basis and in a timely manner.

25.2.6 The group-wide supervisor functions as a key contact point for all other involved supervisors.

25.3 As an other involved supervisor, the supervisor understands:

- **the structure and operations of the group insofar as it concerns the insurance legal entities in its jurisdiction; and**

- **the way that operations of insurance legal entities of the group in its jurisdiction may affect the rest of the group.**

Responsibilities

25.3.1 Responsibilities of other involved supervisors should include:

- actively participating in the group supervision process, such as that facilitated by a supervisory college;
- informing the group-wide supervisor and, if necessary, other involved supervisors, of material findings affecting their insurance legal entity that could affect entities in other jurisdictions;
- sharing all relevant information with the group-wide supervisor to assist with supervision at the group-wide level and discussing findings and concerns at the group level with the group-wide supervisor;
- analysing information received from the group-wide supervisor;
- cooperating in the analysis and decision making as well as implementation and enforcement;
- assisting the group-wide supervisor in carrying out the supervisory process at the group level; and
- identifying gaps in supervision.

Information sharing

25.3.2 Other involved supervisors should provide the group-wide supervisor with relevant information, regarding insurance legal entities within the insurance group, including:

- any granting and withdrawal of a licence;
- location of significant business;
- developments in the legal structure of the insurance group;
- changes in business model;
- changes to the Board or Senior Management;
- changes in the systems of risk management and internal controls;
- significant developments or material changes in the business operations;
- significant developments in the financial position and regulatory capital adequacy;
- significant investments in group legal entities;
- significant financial links;
- the transfer of risks to and from non-regulated legal entities;

- operational risk as well as conduct risk, including mis-selling claims and fraud;
- potential high-risk factors for contagion; and
- events which may endanger the viability of the insurance group or major legal entities belonging to the insurance group.

25.3.3 Other involved supervisors should request information in relation to the group for a timely assessment of an insurance legal entity located in its jurisdiction.

25.4 The group-wide supervisor discusses and agrees with other involved supervisors to establish suitable coordination arrangements for cross-border insurance groups operating in its jurisdiction.

25.4.1 Coordination arrangements, including supervisory colleges, are mechanisms to foster cooperation and coordination between involved supervisors with regard to the supervision of insurance groups, as well as to promote common understanding, communication and information exchange.

25.4.2 The group-wide supervisor should initiate discussions with other involved supervisors about suitable coordination arrangements. Involved supervisors should seek a consensus on the most appropriate form of coordination arrangements.

25.5 The group-wide supervisor sets out the coordination arrangements in a written coordination agreement and puts such arrangements in place.

25.5.1 The scope of coordination arrangements will vary and should reflect the circumstances of the particular insurance group and involved supervisors.

25.5.2 A written coordination agreement should cover activities including:

- information flows between involved supervisors;
- communication with the head of the group;
- convening periodic meetings of involved supervisors;
- the conduct of a comprehensive assessment of the group, including the objectives and process used for such an assessment; and
- supervisory cooperation during a crisis.

25.6 The supervisor discusses and agrees with involved supervisors whether to establish a supervisory college for cross-border insurance groups operating in its jurisdiction, and if so, how to structure and operate the supervisory college.

Establishing a supervisory college

25.6.1 The group-wide supervisor, in cooperation and coordination with other involved supervisors, should consider establishing a supervisory college where, for instance:

- the nature, scale and complexity of the cross-border activities or intra-group transactions are significant and associated risks are high;
- group activities or their cessation could have an impact on the overall stability of the insurance markets in which the insurer operates; and
- the insurance group has significant market share in more than one jurisdiction (see Application Paper on Supervisory Colleges).

Structure and membership of a supervisory college

25.6.2 The group-wide supervisor, in cooperation and coordination with the involved supervisors, should carefully consider the structure of the supervisory college (for example, inclusive, tiered, or regional).

25.6.3 A supervisory college is typically comprised of representatives of each of the supervisors responsible for the day-to-day supervision of the insurance legal entities, including material or relevant branches, which are part of the group and, as appropriate, any supervisors of other material non-insurance entities.

25.6.4 Clear criteria should be established for defining the basis of membership in the supervisory college. Issues which should be considered in establishing these criteria include:

- the relative size and materiality of the insurance legal entity relative to the insurance group as a whole;
- the relative size or materiality of the insurance legal entity relative to its local market;
- the level of risk in a particular insurance legal entity.

25.6.5 The structure of and membership in the supervisory college should be reviewed on a regular basis to reflect changing circumstances in the insurance group.

Coordination agreement for a supervisory college

25.6.6 The purpose of a supervisory college coordination agreement is to establish a framework for the operations of a supervisory college. The agreement is not legally binding and does not create enforceable obligations from one supervisor to another. However, jurisdictions may be subject to an obligation to establish such an agreement.

25.6.7 While recognising the need to allow for flexibility in the operation of a supervisory college, matters covered by the coordination agreement generally should include:

- membership of the supervisory college – including the approach to participation of members in the college;
- the process for appointing a supervisor to chair the college (typically, but not necessarily, the group-wide supervisor);

- roles and functions of the supervisory college and of the members of the supervisory college, including expectations of the chair;
- frequency and locations of meetings (meetings should take place by telephone conference call or other means where an in-person meeting is not practical); and
- scope of the activities of the supervisory college, including ongoing information exchange.

25.6.8 Members of a supervisory college who are not signatories to the IAIS MMoU should enter into a similar long-term agreement covering information exchange and confidentiality, which could be included in the college coordination agreement.

Functions and activities of a supervisory college

25.6.9 The group-wide supervisor, in cooperation and coordination with the other involved supervisors, should establish the appropriate ongoing functions of the supervisory college and clearly allocate those functions among the involved supervisors to avoid unnecessary duplication of supervisory tasks and to ensure no gaps exist in the supervision of the group.

25.6.10 In establishing the functions of a supervisory college, the key activities which should be considered include:

- providing access for involved supervisors to information and knowledge about the group and the environment in which it operates through information sharing;
- assessing group-wide risk exposures, financial position and regulatory capital adequacy and the group-wide corporate governance framework, including risk management, internal control and intra-group relationships such as intra-group transactions and exposures;
- understanding the material operations, solvency and liquidity needs of the material legal entities within the group;
- coordinating supervisory activities such as joint off-site monitoring or on-site inspections or review of one or more entities within the group or of a particular aspect of the group's functions such as internal audit, actuarial, risk management or compliance;
- coordinating appropriate actions to ensure that the group and relevant entities within the group mitigate identified risks;
- forming special focus teams to evaluate areas of particular concern or importance to the involved supervisors, or to bring together the requisite expertise to examine an aspect of the group's operations;
- providing a forum for involved supervisors to interact with the insurer's group-wide Senior Management in order to, for example, inform Senior Management of an identified issue at

an insurance legal entity that affects the whole insurance group; and

- regularly assessing the effectiveness of the supervisory college in fulfilling its agreed role and functions. The assessment should be organised by the group-wide supervisor and take into account input from the other involved supervisors and, as appropriate, legal entities.

25.6.11 Aside from group-wide issues, supervisory colleges may also focus on issues specific to insurance legal entities within the insurance group.

CF 25.6.a The group-wide supervisor establishes a supervisory college for the IAIG, which meets at least annually.

CF 25.6.a.1 If a supervisory college does not already exist, one should be formed and its first meeting should take place in a timely manner after the identification of the IAIG.

CF 25.6.a.2 Priorities for the initial supervisory college meeting should include, at least:

- confirming the group-wide supervisor and the structure of the supervisory college;
- describing the scope of group-wide supervision including, where applicable, an explanation from the group-wide supervisor of its decision to exclude an entity from the scope of group supervision; and
- discussing proposed coordination agreements.

CF 25.6.a.3 When an in-person meeting is not practicable, the meeting should take place by teleconference or other means.

CF 25.6.a.4 The group-wide supervisor should ensure that the IAIG's supervisory college discusses the most relevant elements of the group-wide supervisory process and the supervisory plan. The agenda set by the group-wide supervisor should provide for discussion of at least the IAIG's:

- group-wide corporate governance framework;
- enterprise risk management;
- main risks and intra-group transactions;
- financial position; and
- regulatory capital adequacy and compliance with supervisory requirements.

CF 25.6.a.5 When deciding on the topics to be covered in the IAIG's supervisory college meetings, the group-wide supervisor should cooperate and coordinate with involved supervisors to ensure that matters pertinent at a legal entity level are appropriately raised.

CF 25.6.b The members of the IAIG's supervisory college communicate and exchange information on an ongoing basis.

CF 25.6.c **The members of the IAIG's supervisory college discuss and assess a summary of the reference ICS prepared by the group-wide supervisor, as well as a summary of any additional reporting related to the ICS that has been reported at the option of the group-wide supervisor.**

CF 25.6.c.1 The assessment of the reference ICS and, if applicable, any additional reporting should include:

- a comparison with existing group capital standards or calculations that are in development;
- the extent to which material risks of the IAIG are captured;
- the appropriateness and practicality of the calculations required; and
- any difficulties in implementing the measure by the IAIG.

CF 25.6.c.2 The purpose of the supervisory college discussing and assessing the summary of the reference ICS, and of any additional reporting, is to help refine the ICS.

Supervisory cooperation in planning for crisis management

25.7 **The group-wide supervisor coordinates crisis management preparations with other involved supervisors and relevant authorities.**

Objectives of crisis preparation planning

25.7.1 The main objectives of supervisory crisis management planning should be:

- to protect policyholders; and
- to contribute to domestic or international financial stability to avoid a potential adverse impact on the real economy.

25.7.2 In planning for crisis management the group-wide supervisor and other involved supervisors should seek to:

- promote private sector solutions such as portfolio transfers and run-offs;
- minimise the need to use public support to protect policyholders;
- minimise disruptions to the efficient operation of the insurance sector across jurisdictions; and
- achieve an orderly supervisory response.

Process for crisis management planning

25.7.3 Supervisory actions in planning for crisis management should seek to secure early communication between involved supervisors and relevant authorities in order to maximise time for coordination and cooperation.

25.7.4 The group-wide supervisor should meet regularly with the other involved supervisors and relevant authorities to share and evaluate information relating to the insurance group and to analyse and assess specific issues (including whether there are systemic implications). These meetings may

be held in conjunction with the supervisory college meetings or separately if no supervisory college is in place.

25.7.5 Supervisors should remain aware of potential contagion channels, conflicts of interest and possible barriers to coordinated action in a crisis situation within a specific cross-border insurance group (such as legally required transparency rules in the case of publicly listed companies or particular legislative requirements across jurisdictions).

25.7.6 Effective crisis management should ensure 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. Supervisors and other relevant authorities (eg ministries of finance, central banks, other financial sector supervisors and policyholder protection schemes) should exchange information to facilitate effective crisis management.

25.7.7 The group-wide supervisor should share with the other involved supervisors and relevant authorities information relevant to crisis management, including:

- group structure (focusing on legal, financial and operational intragroup dependencies, which may not be always available to the other authorities);
- inter-linkages between the insurance group and the financial system in each jurisdiction where it operates; and
- potential impediments to a coordinated solution to a crisis.

25.7.8 A supervisory college should plan in advance the process for cooperation and coordination during crisis situations in order to benefit from well-established information and cooperation channels and procedures should a crisis occur. 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 should establish close communication channels with the group Board and Senior Management as well as Significant Owners.

CF 25.7.a The group-wide supervisor establishes a crisis management group for the IAIG with the objective of enhancing preparedness for, and facilitating the recovery and resolution of, the IAIG.

CF 25.7.a.1 A crisis management group may be established under a different name so long as it fulfils the objectives of a crisis management group for the IAIG (IAIG CMG).

CF 25.7.a.2 There should be clear conditions as to the membership of the IAIG CMG. Membership of the IAIG CMG should include:

- the group-wide supervisor;
- the other relevant involved supervisors; and
- to the extent possible, relevant resolution authorities.

CF 25.7.a.3 The supervisory college may qualify as an IAIG CMG if:

- the supervisory college's coordination arrangements address recovery and resolution; and
- membership includes those authorities which would otherwise be members of the IAIG CMG.

CF 25.7.a.4 The IAIG CMG should keep under active review the:

- progress in coordination and information sharing within the IAIG CMG and with host resolution authorities that are not represented in the IAIG CMG;
- processes for recovery planning and resolution planning (where required) for the IAIG; and
- resolvability of the IAIG.

CF 25.7.b The group-wide supervisor puts in place a written coordination agreement between the members of the IAIG CMG.

CF 25.7.b.1 The coordination agreement should describe, at least:

- roles and responsibilities of the respective members of the IAIG CMG; and
- the process for coordination and cooperation, including information sharing, among members of the IAIG CMG.

CF 25.7.b.2 The coordination agreement may take the form of a memorandum of understanding.

Supervisory cooperation during a crisis

25.8 The supervisor:

- **Informs the involved supervisors as soon as it becomes aware of a crisis;**
- **cooperates and coordinates with the involved supervisors and relevant authorities to analyse and assess the crisis situation and its implications to reach a common understanding of the situation; and**
- **identifies coordinated, timely and effective solutions to a crisis situation.**

25.8.1 The group-wide supervisor should coordinate the gathering and analysis of information, as well as coordinate supervisory activities to respond to the crisis.

25.8.2 Such analysis should include:

- implications for policyholder protection in each relevant jurisdiction;
- whether the crisis is of systemic relevance and, if so, the identification of possible sources of systemic risk; and
- processes through which involved supervisors and relevant authorities can respond in a coordinated way.

25.8.3 Such cooperation and coordination 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.

25.9 The group-wide supervisor coordinates with other involved supervisors and relevant authorities on public communication and communication with the insurance group during the crisis.

25.9.1 The group-wide supervisor and other involved supervisors, where practicable, share their plans for public communication among themselves and with other authorities to ensure that communication is handled in a coordinated and timely way.

25.9.2 The group-wide supervisor considers when, and to what extent, to communicate with the insurance group and the insurance legal entities that are part of the group, through their respective insurance legal entity supervisors.