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INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS

PRINCIPLES APPLICABLE TO THE SUPERVISION OF INTERNATIONAL INSURERS AND INSURANCE GROUPS AND THEIR CROSS-BORDER BUSINESS OPERATIONS

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1. Introduction

1. The overall objective of insurance supervision is to maintain efficient, fair, safe and stable insurance markets for the benefit and protection of policyholders. To achieve this objective in an environment where many insurers and insurance groups are rapidly extending their international operations, often into new and emerging markets, there is an increasing need for insurance supervisors to co-operate with each other. The purpose of this paper is therefore to develop practical standards that members may chose to apply, and in this sense to establish principles for co-operation between insurance supervisors in the supervision of the foreign[1] business operations of international insurers and insurance groups with a view to maintaining and enhancing its effectiveness. The main focus is on regulation in the interests of policyholders and potential policyholders of the financial strength of insurers and their ability to pay claims - and not on conduct of business regulation. The principles which are elaborated below should be implemented taking full account of any international obligations which may also be applicable.

2. This paper covers foreign branches (and the equivalent[2]), which are integral parts of an insurer incorporated in a different jurisdiction; foreign subsidiaries, which are legally separate

[1] a) In the United States, the term "foreign" is normally utilised by State supervisors to denote insurers with their head office in another US State. Insurers with a head office outside the United States are designated "alien" insurers. The principles developed in this paper will be applied in the United States taking account of this difference in terminology.
b) The principles will be applied within the European Union (EU) taking account of the provisions for mutual recognition, and the exercise of home jurisdiction control over branches in other EU Member States.

[2] References to branches elsewhere in the paper are to be taken to cover equivalent establishments.

institutions incorporated in a different jurisdiction from that of the parent insurers which have control over them; joint ventures, which are legally separate institutions owned and controlled by two or more parent institutions, at least one of which is incorporated in a different jurisdiction, and not all of which are necessarily insurers; and the cross-border provision of insurance on a services basis.

3. This paper does not consider questions arising from the provision of insurance over the Internet. Nor does it cover the activities of pure reinsurers, which are directly supervised in some jurisdictions but not in others, although this gap may be partly filled by the close interest most supervisors take in the quality of the reinsurance programmes placed by the direct insurers they supervise, or by the imposition of financial or other requirements on reinsurance contracts as a condition for credit being given for reinsurance ceded by direct insurers. These are two areas to which the IAIS will revert.

2. Definitions

4. The following definitions apply to terms used in the paper:

Home jurisdiction. A home jurisdiction is one in which a parent insurer is incorporated, or in which the head office of a branch is incorporated. Host jurisdictions/supervisors must be aware of the distinctions between immediate and higher level home jurisdictions/supervisors, taking account of the hierarchical corporate structures of many international insurers and insurance groups. Except where specified, the terms home jurisdiction/supervisor where they appear cover both immediate and higher levels.

Host jurisdiction. A host jurisdiction is one in which a branch of a foreign insurer is located; or in which a subsidiary or joint venture of a foreign parent insurer is incorporated; or, in the case of the cross-border provision of insurance on a services basis, the jurisdiction in which the service is provided.

Insurer/insurance company both in the text and other definitions refers to a licensed legal entity which underwrites insurance (but note the exemption of pure reinsurers).

Insurance group refers, in this paper, to a group structure which contains two or more insurers. The structure of international insurance groups may derive from an ultimate holding company which is not an insurer. Such a holding company can be an industrial or commercial company, another financial institution (for example a bank) or a company the majority of whose assets consist of shares in insurance companies (and/or other regulated financial institutions).

Jurisdiction refers to a country, state, province, or other jurisdiction with legally enforceable local insurance laws that relate to the incorporation or operation of insurance companies.

Licensing refers, in this paper, to the incorporation of an insurer in the jurisdiction or the approval given to a company to underwrite insurance in the jurisdiction. These are recognised to be separate

approvals and may be made in separate jurisdictions. The principles which apply to licensing apply to both types of approval.

Solo supervision. There is no unique, comprehensive definition of "solo supervision". For the purposes of this paper solo supervision refers to supervision of an insurer by the supervisor in the jurisdiction where the insurer is incorporated: this is bound to cover the whole company, but the focus may be on the protection of all policyholders of the company, or only those in the jurisdiction of the supervisor in question. Under solo supervision there can be no automatic assumption that the entity in question will receive additional financial support from a parent institution, or that it - in turn - will have moral or commercial obligations to support other insurers in which it has invested beyond the extent of those investments, or other contractual obligations (for example guarantees). The concept of solo supervision in the context of this paper is not in any way intended to exclude the possibility of supervision of a branch by a host jurisdiction.

Supervisor refers, as appropriate, to either the insurance regulator or the insurance supervisor in the jurisdiction.

3. Principles for the supervision of cross-border business operations

5. The following principles for the supervision of cross-border business operations are proposed for application by individual supervisors.

Principle 1: No foreign insurance establishments should escape supervision

6. A primary aim of co-operation between insurance supervisors is to ensure that no insurance establishment escapes supervision. Whilst being sensitive to the potential for unnecessary duplication of supervision, each supervisor has a duty to ensure that all foreign insurance establishments in its jurisdiction are effectively supervised. Acceptance of this principle does not remove the possibility of gaps in supervision. Gaps may occur, for example, when an establishment is classified as an insurer by the home supervisor but not by the host supervisor, or vice versa.

7. There are differences in the supervision of subsidiaries and branches. Subsidiaries should always be supervised in the host jurisdiction where they are incorporated, and will be subject to host rules on capital adequacy/solvency. Branches will also usually come under host jurisdiction supervision (except where mutual recognition schemes operate as in the EU). However, branch solvency may be assessed under the provisions applying in both home and host jurisdictions. In some cases the branch's host supervisor may be willing to rely on the home supervisor's assessment.

Principle 2: All insurance establishments of international insurance groups and international insurers should be subject to effective supervision.

8. In deciding whether, and if so on what basis, to license or to continue a licence of a subsidiary or branch of a foreign insurer in its jurisdiction, the host supervisor may need to assess on a case by case basis the effectiveness of the supervision of the foreign insurer in its home jurisdiction, consulting the home supervisor as necessary. This assessment would take into account IAIS general supervisory principles and standards and the ability of the home supervisor to apply sanctions to prevent corporate structures that conflict with effective supervision.

9. The traditional approach to insurance supervision has laid the primary emphasis on effective solo supervision of individual insurance companies. Because insurance companies are less vulnerable to risks of contagion than, for example banks, and because they are more rarely a source of systemic risk to the wider financial system, insurance supervisors seek to ring fence an individual insurer incorporated in their jurisdiction, isolating it from other companies in the same group.

10. Where, however, a parent insurer has material participations in other insurers (or in other financial institutions), it is important to take into account the potential additional risks created by the existence of a group in assessing the financial strength of the parent insurer and the group as a whole: notably the possible effects of double gearing of capital on solvency; intra-group transactions, and large exposures. Work on the prudent treatment of such situations is going on in other fora, and will need in due course to be incorporated into a "solo-plus" or group-wide view of the supervision of international insurance groups. This will not, however, diminish the importance of the effective supervision of international insurers on a solo basis.

Principle 3: The creation of a cross-border insurance establishment should be subject to consultation between the host and home supervisors

11. The initial opportunity for collaboration between host and home supervisors occurs when an individual application by an insurer to establish a new foreign presence is first made. The licensing procedure also offers a good opportunity for host and home authorities to create the basis for future collaboration.

12. Host supervisors may wish to consult home supervisors on particular aspects of an licensing proposal, but in any event they should always consider checking that the home supervisor of the immediate insurance parent has no objection before granting a licence. This process might give an opportunity to a home supervisor which disapproves of its insurer's plans to establish abroad to make its reasons known to the host supervisor, and perhaps recommend that the host supervisor refuse a licence. Where such checks are made and where a host supervisor is unable to obtain a positive reply from a home supervisor with the legal authority to respond, or a qualified response is received, it should consider either refusing the application, increasing the intensity of supervision or

imposing conditions on the grant of a licence. The host supervisor should inform the home supervisor of any restrictions or prohibitions imposed on a licence.

13. Host supervisors should exercise particular caution in approving applications for a licence from foreign entities which are not subject to prudential regulation of their capital strength in the home jurisdiction, or joint ventures for which there is no clear parental responsibility. In such circumstances, any licence should be contingent on the host supervisor's capacity to impose specific restrictions on activities - or require specific guarantees - and supervise the company effectively.

14. The final decision on licensing should remain with the host supervisor on the basis of non-discriminatory criteria (except where a mutual recognition scheme operates as in the EU). Home supervisors should maintain a listing of all the cross-border establishments of their insurers.

Principle 4: Foreign insurers providing insurance cover on a cross-border services basis should be subject to effective supervision

15. Whether or not foreign insurers are permitted to provide insurance services on a cross-border basis in any jurisdiction is usually a matter of law in the jurisdiction concerned.

16. Where consumers have the unrestricted freedom to seek insurance abroad on their own initiative, the presumption is normally that they take responsibility for their own actions. However, where the active promotion of insurance contracts on a cross-border services basis is permitted, the host supervisor may wish to be notified of the intention of a foreign insurer to promote insurance contracts within their jurisdiction, and to check that the foreign insurer is subject to prudential regulation of their capital strength in the home jurisdiction.[3] Another legitimate approach might be the application of a special licensing procedure, or the introduction of specific safeguards to protect the policyholder.

17. If the active promotion of insurance contracts on a cross-border services basis is permitted, the home supervisor will retain the primary responsibility for ensuring that the insurer remains solvent, the host supervisor should consider very seriously any reservations or objections expressed by the home supervisor to the insurer's proposed activity. Home supervisors should have the power to prevent insurers within their jurisdiction from promoting contracts of insurance on a cross-border basis in foreign jurisdictions if they consider that the insurer does not have the required financial capacity, or the necessary expertise to manage this business prudently.

18. Where the host supervisor has been notified of the intention of a foreign insurer to promote insurance contracts within their jurisdiction, the host supervisor should consider what information should be made available to the consumer by the foreign insurer. This might include details of the authority responsible for the supervision of the insurer.

[3] Particular care should be taken where it is proposed that cross-border services be provided through a branch of the foreign insurer located in a jurisdiction other than the home jurisdiction . In such cases both the home supervisor and the supervisor of the branch should be aware of the business being conducted.

4. Aids to cooperation

19. Mutual trust between supervisors is enhanced if information can flow with confidence in both directions on a broadly reciprocal basis. In seeking to improve the supervision of international insurers and insurance groups, efforts continue to be required to improve information exchange between insurers and supervisors, and between different supervisors. The purpose is to address material supervisory issues, not simply to circulate large amounts of routine information. The need to exchange information encompasses the following elements.

4.1 Information needs of home supervisors

20. The principal requirement of the home supervisor is to ensure that its information needs from the parent insurer are fully met in a timely fashion. This will typically require a sound and verifiable system of reporting from any foreign establishment to the head office or parent insurer,[4] and that practical solutions be found for dealing with particular information needs. To this end:

a. Home supervisors should seek to satisfy themselves that insurers' internal controls include comprehensive and regular reporting between an insurer's foreign establishments and its head office, so that the overall financial situation of the insurer and the effectiveness of its control systems can be accurately reported and assessed.

b. If a host supervisor identifies, or has reason to suspect, problems of a material nature in a foreign establishment, it should take the initiative to inform the home supervisor, subject to its own judgement. The level of materiality will vary according to the nature of the problem. Home supervisors may wish to inform host supervisors as to the precise levels of materiality which would trigger their concern. However, the host supervisor is often in the best position to detect problems and therefore should be ready to act on its own initiative.

c. Home supervisors may wish to seek an independent check on data reported by an individual foreign establishment. Where inspection by home supervisors is permitted, host supervisors should welcome such inspections. Where inspection by home supervisors is not at present possible (or where the home supervisor does not use the inspection process), the home supervisor can consult the host supervisor with a view to the host supervisor checking or commenting on designated features of the insurer's activities. It is desirable that the results obtained should be available to both host and home supervisor.

d. If serious problems arise in a foreign establishment, the host supervisor may wish to consult with the head office or parent insurer and also with the home supervisor in order to design possible remedies. Where such consultation with the home supervisor has taken place, and the host supervisor decides to withdraw the licence of a foreign establishment or take similar action, the home supervisor should, where possible and appropriate, be given prior warning.

[4] The home supervisor should ensure that full information is available in the case of outsourced functions.

e. In some instances the host supervisor may, by agreement with the home supervisor, share responsibility for and co-ordinate supervisory activities with the home supervisor.

21. Host supervisors should make the home supervisor aware of any material difficulties arising from the provision of insurance on a cross-border services basis.

4.2 Information needs of host supervisors

22. Host supervision of foreign establishments will be more effective if it is undertaken with an awareness of the extent to which the home supervisor of the immediate parent insurer monitors the foreign establishment and of any prudential constraints placed on the parent insurer or the group as a whole. To this end:

a. Home supervisors should inform host supervisors of changes in supervisory measures which have a significant bearing on the operations of their insurers' foreign establishments, subject to their own judgement. Home supervisors should respond positively to approaches from host supervisors for factual information covering, for example, the scope of the activities of a local establishment, its role within the insurance group and the application of internal controls and for information relevant for effective supervision by host supervisors.

b. Where a home supervisor has doubts about the standard of host supervision in a particular jurisdiction and, as a consequence, is envisaging action which will affect foreign establishments in the jurisdiction concerned, the home supervisor should consult the host supervisor in advance.

c. In the case of particular insurers, home supervisors should be ready to take host supervisors into their confidence as much as possible. Even in sensitive cases such as impending changes of ownership or when an insurer faces problems, liaison between home and host supervisors may be mutually advantageous, though decisions on both substance and timing on such sensitive issues can only be taken case by case.

23. Home supervisors should respond positively to approaches from host supervisors seeking factual information on individual insurers known to be providing insurance on a cross-border services basis.

4.3 Confidentiality constraints on the flow of information

24. The freedom to exchange prudential information, subject to certain conditions designed to protect both the provider and receiver of the information, greatly enhances effective collaboration between supervisors. A possible obstacle to the transmission of prudential information is the different level of confidentiality regulations in different jurisdictions.

25. Jurisdictions whose confidentiality requirements continue to constrain or prevent the sharing of information for supervisory purposes with insurance supervisors in other jurisdictions, and the

countries where information received from a foreign supervisor cannot be kept confidential, are urged to review their requirements in consideration of the following conditions:

a. Information received should only be used for purposes related the supervision of financial institutions.

b. Information sharing arrangements should allow for a two-way flow of information, but strict reciprocity in respect of the format and detailed characteristics of the information should not be demanded.

c. The confidentiality of information transmitted should be legally protected, except in the event of criminal prosecution.[5] All insurance supervisors should, of course, be subject to professional secrecy constraints in respect of information obtained in the course of their activities, including during the conduct of on-site inspections.

d. The recipient should undertake, where possible, to consult with the supervisor providing the information if he proposes to take action on the evidence of the information received.

26. Supervisors may wish to consider, on a case by case basis, and consulting each other as necessary, the appropriateness of informing the companies on which they have exchanged information of the nature of the contact made.

5. External audit

27. Supervisors can gain reassurance from sound international auditing and actuarial standards. At present, not all foreign establishments are subject to external audit and, even where they are, the audit work may not be sufficiently thorough. All foreign establishments should be subject to external audit, where necessary either at the instigation of the home or host supervisor.

28. The existence of adequate provision for external audit is an important consideration for insurance supervisors, and might be a factor taken into account in deciding on licences for new establishments. For the foreign establishments of international insurers and insurance groups the audit firm may often be the one that audits the parent insurer, provided the firm in question has the appropriate capacity and experience in the host jurisdiction. Where a foreign establishment is audited by a different firm, it is desirable that the external auditor and the insurance supervisor of the parent insurer satisfy themselves as to the proper audit of the foreign establishment.

29. Supervisors have a strong interest in the quality and thoroughness of audits. Where audits are inadequately conducted, supervisors should address criticism to the local representative body of auditors. It is desirable that the insurance supervisor be empowered, where necessary, to insist on a further audit by a different auditor or to have the auditor replaced. As a means of raising auditing

[5] Supervisors may also be subpoenaed to give evidence in civil cases. Although in some jurisdictions they may be open to contempt of court if they refuse, they can make clear that, if the court insists, the information flow would dry up and their own ability to supervise effectively in future would be impaired.

standards for international insurance groups, it is desirable that auditors with recognised experience of insurance audit, including within the jurisdiction concerned, be appointed. Where any doubt arises, host and home supervisors should consider consulting.

30. External auditors may also be asked to verify the accuracy of reporting returns or compliance with any special conditions. It is desirable that all supervisors should have the ability to communicate with insurance external auditors and vice versa. Effective co-ordination between insurance supervisors and external auditors is encouraged. However, whilst external auditors can play a key role, their involvement does not reduce in any way the need for sound internal controls, including provision for effective internal audit.