

# **INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS**



## **INSURANCE CORE PRINCIPLES AND METHODOLOGY**

**October 2003**

[This document was prepared by the Task Force on the Revisions to the Insurance Core Principles in consultation with members and observers.]

---

## Insurance core principles and methodology

---

The *Insurance core principles and methodology* consist of

- essential principles that need to be in place for a supervisory system to be effective
- explanatory notes that set out the rationale underlying each principle
- criteria to facilitate comprehensive and consistent assessments.

This document should serve as a basic benchmark for insurance supervisors in all jurisdictions. It can be used when establishing a supervisory regime or for identifying areas in existing regimes that need to be improved.

Public authorities concerned with issues of financial stability are urged to provide the necessary support to the supervisory authority so that it can meet the principles and the criteria set out herein.

### Contents

|    |   |    |
|----|---|----|
| 1. | Introduction.....   | 4  |
| 2. | Conditions for effective insurance supervision.....           | 6  |
|    | ICP 1 Conditions for effective insurance supervision .....    | 6  |
| 3. | The supervisory system.....                                   | 8  |
|    | ICP 2 Supervisory objectives .....                            | 8  |
|    | ICP 3 Supervisory authority.....                              | 9  |
|    | ICP 4 Supervisory process .....                               | 12 |
|    | ICP 5 Supervisory cooperation and information sharing.....    | 13 |
| 4. | The supervised entity .....                                   | 14 |
|    | ICP 6 Licensing .....   | 14 |
|    | ICP 7 Suitability of persons .....                            | 16 |
|    | ICP 8 Changes in control and portfolio transfers.....         | 17 |
|    | ICP 9 Corporate governance .....                              | 19 |
|    | ICP 10 Internal control.....                                  | 21 |
| 5. | On-going supervision.....                                     | 23 |
|    | ICP 11 Market analysis.....                                   | 23 |
|    | ICP 12 Reporting to supervisors and off-site monitoring ..... | 24 |
|    | ICP 13 On-site inspection .....                               | 25 |
|    | ICP 14 Preventive and corrective measures.....                | 27 |
|    | ICP 15 Enforcement or sanctions .....                         | 28 |
|    | ICP 16 Winding-up and exit from the market.....               | 30 |
|    | ICP 17 Group-wide supervision .....                           | 30 |
| 6. | Prudential requirements.....                                  | 32 |
|    | ICP 18 Risk assessment and management.....                    | 32 |
|    | ICP 19 Insurance activity.....                                | 33 |
|    | ICP 20 Liabilities .....                                      | 34 |
|    | ICP 21 Investments .....                                      | 35 |
|    | ICP 22 Derivatives and similar commitments.....               | 37 |
|    | ICP 23 Capital adequacy and solvency .....                    | 39 |
| 7. | Markets and consumers .....                                   | 40 |
|    | ICP 24 Intermediaries.....                                    | 40 |
|    | ICP 25 Consumer protection .....                              | 41 |

|  |    |
|--|----|
| ICP 26 Information, disclosure & transparency towards the market.....              | 42 |
| ICP 27 Fraud .....   | 43 |
| 8. Anti-money laundering, combating the financing of terrorism.....                | 45 |
| ICP 28 Anti-money laundering, combating the financing of terrorism (AML/CFT) ..... | 45 |
| Annex 1 - References .....   | 47 |
| Annex 2 - Assessment methodology .....   | 50 |

## 1. Introduction

1. To contribute to economic growth, efficiently allocate resources, manage risk, and mobilise long-term savings, the insurance sector must operate on a financially sound basis. A well-developed insurance sector also helps enhance overall efficiency of the financial system by reducing transaction costs, creating liquidity, and facilitating economies of scale in investment. A sound regulatory and supervisory system is necessary for maintaining efficient, safe, fair and stable insurance markets and for promoting growth and competition in the sector. Such markets benefit and protect policyholders<sup>1</sup>. Sound macroeconomic policies are also essential for the effective performance of insurance supervisory regimes.

2. The insurance industry, like other components of the financial system, is changing in response to a wide range of social and economic forces. In particular, insurance and insurance-linked financial activities are increasingly crossing national and sectoral boundaries. Technological advances are facilitating innovation. Insurance supervisory systems and practices must be continually upgraded to cope with these developments. Furthermore insurance and other financial sector supervisors and regulators should understand and address financial and systemic stability concerns arising from the insurance sector as they emerge.

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

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

5. Finally, the supervisory framework needs to reflect the increasing presence in the market of financial conglomerates and groups, as well as financial convergence. The importance of the insurance sector for financial stability has been increasing. This trend has implications for insurance supervision as it requires more focus on a broader set of risks. Supervisory authorities at a national and international level must collaborate to ensure that these entities are effectively supervised so that business and individual policyholders are protected and financial markets remain stable; to avoid

---

<sup>1</sup> In this document policyholder includes beneficiaries.

contagious risks being transferred from one sector or jurisdiction to another; and to avoid supervisory duplication.

### **Scope and coverage of the *Insurance core principles***

6. The *Insurance core principles* provide a globally-accepted framework for the regulation and supervision of the insurance sector. IAIS principles, standards and guidance papers expand on various aspects. They provide the basis for evaluating insurance legislation, and supervisory systems and procedures.

7. The principles apply to the supervision of insurers and reinsurers, whether private or government-controlled insurers that compete with private enterprises, wherever their business is conducted, including through e-commerce. The term insurer refers to both insurers and reinsurers. Where the principles do not apply to reinsurers (such as, consumer protection), this is indicated in the text. Conversely, the core principles do not normally apply to the supervision of intermediaries, however, where they do this is specifically indicated.

8. Insurance supervision within an individual jurisdiction may be the responsibility of more than one authority. For example, the body that sets out the legal framework for insurance supervision may be different from the body that implements it. In this document, the expectation is that the core principles are applied within the jurisdiction rather than necessarily by one supervisory authority. It is, however, essential that in situations where multiple authorities exist, coordination arrangements be established to ensure the implementation of the core principles within an accountable framework.

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

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

### **Implementation and assessment**

11. The *Insurance core principles* can be used to establish or enhance a jurisdiction's supervisory framework. They can also serve as the basis for assessing the existing supervisory framework and in so doing may identify weaknesses, some of which could affect policyholder protection and market stability. In order to ensure that the core principles are interpreted and implemented in a consistent manner by insurance supervisory authorities, each principle is followed by an explanatory note and criteria. Annex 1 contains a list of IAIS principles, standards and guidance documents, as well as selected codes, that expand on some of the core principles. This list will be updated as new principles, standards and guidance are developed. Annex 2 sets out factors that should be considered when using or implementing these principles and describes how observance should be evaluated.

12. The criteria, which must be implemented both in form and in practice, consist of two distinct groupings:

- (i) essential criteria, or those components that are intrinsic to the implementation of the core principle. All the essential elements should be met for a supervisory authority to demonstrate “observed” status for each principle.
- (ii) advanced criteria, or those components that are considered to improve on the essential criteria and thus enhance the supervisory regime. Advanced criteria are not used for assessing observance with a principle, rather they are used when commenting on a jurisdiction’s supervisory framework and making recommendations<sup>2</sup>.

13. While implementing the criteria in a jurisdiction, and when carrying out the assessment, it is important to take into account the domestic context, industry, structure and stage of development of the financial system and overall macroeconomic conditions. The ways and means of implementation will vary across jurisdictions, and while good implementation practices should be kept in mind, there is no mandated method of implementation. For example, in some jurisdictions the supervisory authority may, within clear limits and following a consultative process, be able to issue guidelines or establish regulations that insurers must follow, whereas in other jurisdictions these powers may reside with the legislature.<sup>3</sup>

14. For a core principle to be regarded as being “observed” the essential criteria must be met without any significant shortcomings although there may be instances, where one can demonstrate that the principles have been observed through different means other than those identified in the criteria. Conversely, owing to the specific conditions in individual jurisdictions, the criteria identified in this document may not always be sufficient to achieve the objective of the specific principle and therefore additional elements may have to be taken into account.

## 2. Conditions for effective insurance supervision

|              |   |
|--------------|---|
| <b>ICP 1</b> | <b>Conditions for effective insurance supervision</b> |
|--------------|---|

Insurance supervision relies upon

- a policy, institutional and legal framework for financial sector supervision
- a well developed and effective financial market infrastructure
- efficient financial markets.

### Explanatory note

1.1. Implementation of the principle depends upon the existence of a sound financial policy and institutional environment, as well as a properly functioning financial sector and legal infrastructure.

1.2. This is essential for the supervisory authority to perform its functions and meet its supervisory objectives effectively. The lack of any, or a combination of, essential conditions could affect the quality and efficacy of insurance supervision.

---

<sup>2</sup> Recommendations may also arise from comments made about the observation of the essential criteria.

<sup>3</sup> In this document, “law” requires full legislative consent; “legislation” refers to either laws or other forms of regulatory rules (e.g., regulations, decrees, ordinance).

1.3. This principle identifies elements of the economic, legal and financial sector environment and the supporting market infrastructure that need to be present. In most jurisdictions these elements are not defined or controlled by the supervisory authority and are also required for the effective functioning of other sectors as well.

1.4. The existence of an effective financial sector policy and an appropriate institutional and legal framework is necessary to ensure the stable and efficient operation of the financial system. It also facilitates formal and closer co-ordination among the relevant supervisory authorities and with the government, and enhances stakeholders' confidence in the supervisory regime. Good laws alone are not enough. The legal system must provide support in honouring and enforcing insurance contracts.

1.5. Another essential condition for effective supervision is for the supervisor to establish credibility and respect in the market vis-à-vis stakeholders, especially insurers and intermediaries. Credibility and respect are a function of many factors including relevant laws and rules, consultation with the industry, and the quality of supervision and supervisory staff.

1.6. Similarly, insurance supervision can be severely constrained by inadequacies in the financial sector infrastructure, such as weaknesses in the national accounting standards or the lack of actuarial skills and insurance expertise. Accurate financial data requires qualified experts including accountants, auditors and financial analysts and access to reliable and comparable economic and social statistics for the proper evaluation of risks. In order to conduct asset liability management a broad-based, liquid and well-functioning money and securities markets are also essential.

1.7. Where the conditions for effective insurance supervision are not yet sufficient, the insurance supervisor could have additional powers to put in place rules and procedures and prudential rules to address the weaknesses.

### **Financial sector policy framework**

#### *Essential criteria*

- a. The government establishes and publicly discloses a policy statement aimed at ensuring financial stability, including the provision of effective financial sector supervision covering the insurance and other financial sectors.
- b. An institutional and legal framework – comprising public institutions, laws and regulations – exists for financial sector issues, including those pertaining to insurance, to address system-wide issues. This framework is well-defined and publicly disclosed.

### **Financial market infrastructure**

#### *Essential criteria*

- c. There is a reliable, effective, efficient and fair legal and court system (a body of ethical, professional and trained lawyers and judges) whose decisions are enforceable. Alternative dispute mechanisms operate within an appropriate legal framework.
- d. Accounting, actuarial and auditing standards are comprehensive, documented, transparent and consistent with international standards. Accounting and actuarial standards are applied and disclosed in a manner that allows current and prospective policyholders, investors, intermediaries, creditors and supervisors to properly evaluate the financial condition of insurers.

- e. Accountants, actuaries and auditors are competent and experienced and comply with technical and ethical standards to ensure the accuracy and reliability of financial data and its interpretation. Auditors are independent from the insurer.
- f. Professional bodies set and enforce technical and ethical standards. These standards are accessible to the public.
- g. Basic economic, financial and social statistics are available to the supervisory authority, the industry and the public.

***Advanced criteria***

- h. Laws and regulations are updated, as necessary, to reflect current best practices and industry conditions.

**Efficient financial markets**

***Essential criteria***

- i. Well-functioning money and securities markets exist to support the availability of both long-term and short-term investment opportunities.

**3. The supervisory system**

|              |                               |
|--------------|-------------------------------|
| <b>ICP 2</b> | <b>Supervisory objectives</b> |
|--------------|-------------------------------|

|  |
|--|
| The principal objectives of insurance supervision are clearly defined. |
|--|

**Explanatory note**

2.1. The insurance law should include a clear statement of the mandate and responsibilities of the supervisory authority. This gives prominence to the authority's role. Publicly defined objectives also foster transparency. With this basis the public, government, legislatures and other interested bodies can form expectations about insurance supervision and assess how well the authority is achieving its mandate and fulfilling its responsibilities legislation.

2.2. Being entrenched in law also ensures that the mandate and functions of the supervisory authority cannot be changed on an *ad hoc* basis. The process of periodically altering the governing laws can promote transparency by way of public discussions on relevant issues; however, if done too frequently stakeholders may form the impression that the policymaking process is unstable. Therefore it would be prudent to avoid being overly specific. Instead the law could be supplemented as needed with updated regulations, for example.

2.3. The law should also set forth the institutional framework or the basic conceptual structure governing the institutions involved in the design and implementation of insurance supervisory policies, identifying, wherever appropriate, the broader set of relevant financial agencies and the nature of the relationships among them.



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

#### ***Essential criteria***

- a. Legislation or regulation clearly defines the objectives of insurance supervision .
- b. The key objectives of supervision promote the maintenance of efficient, fair, safe and stable insurance markets for the benefit and protection of policyholders.
- c. In the event that the law mandates or specifies multiple objectives for insurance supervision, the supervisory authority discloses and explains how each objective will be applied.
- d. The supervisory authority gives reasons for and explains any deviations from its objectives.
- e. Where objectives are contradictory, the supervisory authority initiates or proposes correction in law or regulation.

#### **ICP 3 Supervisory authority**

The supervisory authority:

- has adequate powers, legal protection and financial resources to exercise its functions and powers
- is operationally independent and accountable in the exercise of its functions and powers
- hires, trains and maintains sufficient staff with high professional standards
- treats confidential information appropriately.

#### **Explanatory note**

3.1. The supervisory authority must be fully empowered to achieve its objectives. The principle therefore covers the following essential elements relating to a supervisory authority: its legal basis, independence and accountability, powers, financial resources, human resources, legal protection and confidentiality.

3.2. Independence, accountability, transparency and integrity interact and reinforce each other. Transparency is a vehicle for safeguarding independence, ensuring accountability, and establishing and safeguarding integrity.

3.3. To support the independence and integrity of the supervisors, there should be provisions for the legal protection of staff, as well as clear rules for appointment and removal of the head of the supervisory authority. These should be publicly disclosed. The supervisory authority should be operationally independent from external political and commercial interference in the exercise of its functions and powers. Independence enhances the credibility and effectiveness of the supervisory process. The existence of an appeals mechanism through the courts helps ensure that regulatory and supervisory decisions are made within the law consistently and are well reasoned.

3.4. It is important to define the relationship between the supervisory authority and the executive and judicial branches, including processes for sharing information, consultation or approval with the relevant ministry and the manner in which the supervisory authority could be subject to judicial

review. This might include establishing what information should be provided, how each entity should consult on matters of mutual interest and when approval from relevant ministries is necessary.

## **Legal framework**

### ***Essential criteria***

- a. The legislation identifies the authority (or authorities) responsible for the supervision of insurance entities.
- b. The legislation gives the supervisory authorities the power to issue and enforce rules by administrative means (refer to ICP 4 EC a).
- c. The legislation grants sufficient powers for the effective discharge of supervisory responsibilities.

## **Independence and accountability**

### ***Essential criteria***

- d. The governance structure of the supervisory authority is clearly defined. Internal governance procedures necessary to ensure the integrity of supervisory operations, including internal audit arrangements, are in place.
- e. There are explicit procedures regarding the appointment and dismissal of the head and members of the governing body. When the head of an authority or the governing body is removed from office, the reasons are publicly disclosed.
- f. The institutional relationships between the supervisory authority and executive and the judiciary branches are clearly defined and transparent. Circumstances where executive overrides are allowed are specified.
- g. The supervisory authority and its staff are free from undue political, governmental and industry interference in the performance of supervisory responsibilities.
- h. The supervisory authority is financed in a manner that does not undermine its independence from political, governmental or industry bodies.
- i. The supervisory authority has discretion to allocate its resources in accordance with its mandate and objectives and the risks it perceives.
- j. The supervisory authority has transparent processes and procedures for making supervisory decisions. Supervisory decisions are demonstrably consistent.
- k. All material changes to the insurance legislation and supervisory practices are normally subject to prior consultations with market participants.

### ***Advanced criteria***

- l. Representatives of the supervisory authority publicly explain their policy objectives, and report on their activities and performance in pursuing their objectives.

- m. Subject to confidentiality considerations, information is provided publicly about problem or failed insurers, including information on official actions taken.

## **Powers**

### *Essential criteria*

- n. When necessary, the supervisory authority has the power to take immediate action to achieve its objectives, especially to protect policyholders' interests (refer to ICP 4 EC e).

## **Financial resources**

### *Essential criteria*

- o. The supervisory authority has its own budget sufficient to enable it to conduct effective supervision. The supervisory authority is able to attract and retain highly skilled staff, hire outside experts as necessary, provide training, and rely upon an adequate supervisory infrastructure and tools.
- p. The supervisory authority publishes audited financial statements on a regular basis.

## **Human resources and legal protection**

### *Essential criteria*

- q. The supervisory authority and its staff
- observe the highest professional standards
  - have the appropriate levels of skills and experience have the necessary legal protection to protect them against lawsuits for actions taken in good faith while discharging their duties, provided they have not acted illegally
  - are adequately protected against the costs of defending their actions while discharging their duties
  - act with integrity. Supervisory staff are subject to conflict of interest rules, such as prohibition on dealing in shares and investing in the companies they supervise. The supervisory authority establishes and enforces a code of conduct that applies to all staff members.
- r. The supervisory authority has the authority to hire, contract or retain the services of external specialists through contracts or outsourcing arrangements if necessary.
- s. Where supervisory functions are outsourced to third parties, the supervisory authority is able to assess their competence, monitor their performance, and ensure their independence from the insurer or any other related party.

## **Confidentiality**

### *Essential criteria*

- t. The supervisory authority maintains appropriate safeguards for the protection of confidential information in its possession. Other than when required by law, or when requested by another supervisor who has a legitimate supervisory interest and the ability to uphold the confidentiality of the requested information, the supervisory authority denies requests for confidential information in its possession (refer to ICP 5).

- u. External specialists hired by the supervisory authority are subject to the same confidentiality and code of conduct requirements as the staff of the supervisory authority.

#### **ICP 4 Supervisory process**

The supervisory authority conducts its functions in a transparent and accountable manner.

#### **Explanatory note**

4.1. The public's knowledge of and appropriate consultation on the supervisory process is important to the effectiveness and credibility of the supervisor. Accordingly, the supervisor should make available to the public written information about its organisation and activities.

4.2. The supervisory authority should make available to the public the text of proposed and existing regulations. This would include not only substantive rules of general applicability but also policies and interpretations that are not confidential but that may affect a member of the public. The supervisory authority's public information should include information about how the public can interact with its officials. It would be appropriate also to describe the manner in which and on what timetable the supervisory authority intends to respond.

4.3. The supervisory authority must be accountable for the actions it takes in fulfilling its mandate to those who delegated the responsibility - the government or the legislature - as well as to those it supervises and the public at large. It should provide the rationale for decisions taken.

4.4. In general, proper accountability requires a complex combination of approaches, such as legislative and executive oversight, strict procedural requirements, and disclosure. In addition the supervisory authority establishes internal processes for ensuring it is meeting its objectives and complying with legislation.

#### ***Essential criteria***

- a. The supervisory authority adopts clear, transparent and consistent regulatory and supervisory processes. The rules and procedures of the supervisory authority are published and updated regularly.
- b. The supervisory authority applies all regulations and administrative procedures consistently and equitably, taking into account the different risk profiles of insurers.
- c. The administrative decisions of the supervisory authority can be subject to substantive judicial review. However, such action must not unduly impede the ability of the supervisory authority to make timely interventions in order to protect policyholders' interests.
- d. The supervisory authority makes information on its role publicly available.
- e. The decision-making lines of the supervisory authority are so structured that action can be taken immediately in the case of an emergency situation (refer to ICP 3 EC n and ICP 15).
- f. The process to appeal supervisory decisions is specified and balanced to preserve supervisory independence and effectiveness.

- g. The supervisory authority publishes a regular report – at least annually and in a timely manner – on the conduct of its policy, explaining its objectives and describing its performance in pursuing its objectives.

***Advanced criteria***

- h. The supervisory authority provides and publishes information about the financial situation of the insurance industry and observations on major developments in the insurance or financial market.

**ICP 5 Supervisory cooperation and information sharing**

The supervisory authority cooperates and shares information with other relevant supervisors subject to confidentiality requirements.

**Explanatory note**

5.1. Efficient and timely exchange of information among supervisory bodies, both within the insurance sector and across the financial services sector, is critical to the effective supervision particularly in the case of internationally active insurers, insurance groups and financial conglomerates. This is also essential in the context of the effective supervision of the financial system as a whole.

5.2. Information sharing arrangements should facilitate prompt and appropriate action in situations where material supervisory issues need to be addressed. Increasingly supervisors need to share information on matters relating to fraud, anti-money laundering and the combating of financing of terrorism.

5.3. The supervisory authority maintains the confidentiality of the supervisory information it receives from another supervisor. Without adequate safeguards on confidentiality, supervisors will find that their access to confidential information is denied or delayed and their ability to carry out supervisory responsibilities severely diminished.

***Essential criteria***

- a. The existence of a formal agreement with another supervisor is not a prerequisite for information sharing.
- b. The supervisory authority, at its discretion, can enter into agreements or understandings with any other financial sector supervisor (“another supervisor”) to share relevant supervisory information or to otherwise work together.
- c. When reasonably requested and with appropriate safeguards, the supervisory authority is able to exchange with another supervisor (refer to ICP 7 EC e) the following:
- relevant supervisory information, including specific information requested and gathered from a supervised entity
  - relevant financial data
  - objective information on individuals holding positions of responsibility in such entities.
- d. Information sharing, whether carried out under formal or informal arrangements, allows for a two-way flow of information without requiring strict reciprocity in terms of the level, format and detailed characteristics of the information exchanged.

- e. The home supervisory authority provides relevant information to the host supervisor.
- f. The supervisory authority is required to take reasonable steps to ensure that any information released to another supervisor will be treated as confidential by the receiving supervisor and will be used only for supervisory purposes.
- g. The supervisory authority consults with another supervisor if it proposes to take action on the evidence of the information received from that supervisor.
- h. The home supervisory authority informs relevant host supervisors of any material changes in supervision that may have a significant bearing on the operations of foreign establishments operating in their jurisdictions.
- i. Where possible, the home supervisory authority informs the host supervisor in advance of taking any action that will affect the foreign establishment in the host supervisor's jurisdiction.
- j. Where possible, the host supervisory authority informs the home supervisor in advance of taking any action that will affect the parent company or headquarters in the home supervisor's jurisdiction.

#### 4. The supervised entity

|              |                  |
|--------------|------------------|
| <b>ICP 6</b> | <b>Licensing</b> |
|--------------|------------------|

|   |
|---|
| <p>An insurer must be licensed before it can operate within a jurisdiction. The requirements for licensing are clear, objective and public.</p> |
|---|

##### **Explanatory note**

6.1. To protect the interest of policyholders a jurisdiction must be able to determine which insurers are allowed to carry out insurance activities within its area. Licensing refers to the formal authority given to an insurer to carry on insurance business under the domestic insurance legislation. It does not refer to any approval granted in terms of the general domestic company or business legislation.

6.2. When the licensing procedure meets internationally accepted standards and is effective and impartial, confidence in the supervisory system will grow and may facilitate mutual recognition of supervisory systems and thus the further liberalisation of market access for foreign insurers. Licensing procedures and conditions are in place for supervisory purposes; they should not in themselves act as a barrier to market access.

##### ***Essential criteria***

- a. The insurance legislation:
  - includes a definition of insurers
  - requires licensing of insurers, and prohibits unauthorised insurance activities
  - defines the permissible legal forms of insurers
  - allocates the responsibility for issuing licences.

- b. Clear, objective and public licensing criteria require:
- the applicant’s board members, senior management, auditor and actuary both individually and collectively to be suitable, as specified in ICP 7
  - the applicant’s significant owners (refer to ICP 8 EC a) to be suitable, as specified in ICP 7
  - the applicant to hold the required capital
  - the applicant’s risk management systems including reinsurance arrangements, internal control systems, information technology systems, policies and procedures to be adequate for the nature and scale of the business in question
  - information on the applicant’s business plan projected out for a minimum of three years. The business plan must reflect the business lines and risk profile, and give details of projected setting-up costs, capital requirements, projected development of business, solvency margins and reinsurance arrangements. The business plan must present information regarding primary insurance and inward reinsurance separately
  - information on the products to be offered by the insurer
  - information on contracts with affiliates and outsourcing arrangements
  - information on the applicant’s reporting arrangements, both internally to its own management and externally to the supervisory authority
  - input from the applicant’s home supervisory authority when the insurer or its owners are not domestic and a home supervisory authority exists (refer to ICP 5).
- c. The supervisory authority requires that no domestic or foreign insurance establishment escape supervision.
- d. All insurance establishments of international insurance groups and international insurers are subject to effective supervision. The creation of a cross border establishment should be subject to consultation between the host and home supervisor.
- e. The insurance legislation determines the method by which a foreign insurer can carry on business in the jurisdiction. This may be by way of a local branch or subsidiary that must be licensed, or on a services basis only.
- f. If a foreign insurer is allowed to carry on business in the jurisdiction the supervisory authority must be provided with the following data:
- confirmation from the home supervisory authority that the insurer is authorised to carry on the types of insurance business proposed
  - information from the home supervisory authority that the insurer is solvent and meets all the regulatory requirements in the home jurisdiction
  - in the case of a branch office: the name and address of the branch
  - the name of the authorised agent in the local jurisdiction in the case of insurance offered on a services basis (i.e., where a local branch or subsidiary is not established)
  - the information and documentation normally required to be licensed in the local jurisdiction, when appropriate
- These information requirements might be waived if insurance is offered on a services basis only.
- g. An insurer licensed to underwrite life insurance business must not also be licensed to underwrite non-life insurance business, and vice versa, unless the supervisory authority is satisfied that the insurer has satisfactory processes requiring that risks be handled separately on both a going-concern and a winding-up basis.

- h. The supervisory authority imposes additional requirements, conditions or restrictions on an applicant where the supervisory authority considers this appropriate. This might include restrictions on non-insurance activities.
- i. The supervisory authority assesses the application and makes a decision within a reasonable time. No licence is issued without its approval. The applicant must be informed of the decision without delay and, if the licence is denied or conditional, be provided with an explanation.
- j. The supervisory authority refuses to issue a licence where it considers the applicant not to have sufficient resources to maintain the insurer's solvency on an on-going basis, where the organisational (or group) structure hinders effective supervision, or where the application is not in accordance with the licensing criteria.
- k. As necessary, after an insurer has been licensed, the supervisory authority evaluates and monitors the degree to which the insurer satisfies the relevant licensing principles and requirements of the jurisdiction.

|              |                               |
|--------------|-------------------------------|
| <b>ICP 7</b> | <b>Suitability of persons</b> |
|--------------|-------------------------------|

|  |  |
|--|--|
|  | The significant owners, board members, senior management, auditors and actuaries of an insurer are fit and proper to fulfil their roles. This requires that they possess the appropriate integrity, competency, experience and qualifications. |
|--|--|

**Explanatory note**

7.1. An important element of the supervision of insurers is the initial and on-going assessment of the fitness and propriety of an insurer's significant owners and key functionaries such as board members, senior management, auditors and actuaries. In the case of significant owners, fit and proper requirements relate to the persons and their financial soundness. A significant owner is defined as a person (legal or natural) that directly or indirectly, alone or with an associate, exercises control over the insurer (refer to ICP 8 EC a). The main responsibility for assessment of the fitness and propriety of key functionaries lies with the insurers themselves.

7.2. The supervisory authority should be satisfied that significant owners and key functionaries have the level of competence for their roles, and should ascertain whether they have the appropriate ability and integrity to conduct insurance business, taking account of potential conflicts of interests. Appropriate ability can generally be judged from the level of a person's professional or formal qualifications or relevant experience within the insurance and financial industries or other related businesses.

***Essential criteria***

- a. Legislation identifies which key functionaries must meet fit and proper requirements. The key functionaries identified may differ depending on the legal form and governance structure of the insurer.
- b. In cases where significant owners no longer meet fit and proper requirements, the supervisory authority must be able to take appropriate action, including requiring that the owners dispose of their interests.
- c. The supervisory authority disqualifies the appointment of key functionaries including auditors and actuaries of insurers that do not comply with fit and proper requirements



- d. The insurer should be required to demonstrate to the supervisory authority the fitness and propriety of key functionaries by submitting documentation illustrating their knowledge, experience, skills and integrity upon request, or where there are changes in key functionaries. The knowledge and experience required depends on the position and responsibility of the functionary within the insurer.
- e. The supervisory authority exchanges information with other authorities inside and outside its jurisdiction where necessary to check the suitability of persons. The supervisory authority uses this information as an additional tool to effectively assess the fitness and propriety of, or to obtain information on, a key functionary of an insurer (refer to ICP 5).
- f. The supervisory authority disallows actuaries, auditors, directors and senior managers, from simultaneously holding two positions in an insurer where this could result in a material conflict.
- g. Where the insurer becomes aware of circumstances that may be relevant to the fitness and propriety of its key functionaries, it is required to notify the supervisory authority as soon as possible.

***Advanced criteria***

- h. Criteria to assess the fitness and propriety of auditors' and actuaries' include qualifications, professional proficiency, appropriate practical experience and updated knowledge on developments within their profession and membership of professional bodies.
- i. In the case of auditors and actuaries, the supervisory authority may give regard to or rely on professional bodies that set and enforce standards of professional conduct.

**ICP 8      Changes in control and portfolio transfers**

The supervisory authority approves or rejects proposals to acquire significant ownership or any other interest in an insurer that results in that person, directly or indirectly, alone or with an associate, exercising control over the insurer.

The supervisory authority approves the portfolio transfer or merger of insurance business.

**Explanatory note**

8.1. The supervisory authority must be able to grant or deny approval to a person (legal or natural) that wants to acquire significant ownership or a controlling interest in an insurer, whether directly or indirectly, alone or with an associate. The concepts of significant ownership or control should be defined in legislation.

8.2. Notification should be required for changes in ownership or control according to the percentages of an insurer's issued shares. These established percentages typically range between 5 and 10 percent. Where supervisory approval is required in addition to notification, specific thresholds (equal to or higher than those for notification) should be set.

8.3. The supervisory authority must require that the proposed owners have the resources to provide the minimum capital required as well as the ability to provide further capital or other support for the insurer when needed.

8.4. Owners should not expose the insurer to undue risks or hinder effective supervision. The supervisory authority should be satisfied about what constitutes an insurance group or conglomerate and which entities are considered to be part of such a group. The structure and risk profile of the group to which the insurer belongs should not damage the insurer's stability and solvency (refer to ICP 17).

8.5. Changes in control have an indirect effect on the contractual arrangements between insurer and policyholder, whereas a portfolio transfer will have a direct effect on this relationship. For this reason supervisory authorities should closely monitor portfolio transfers.

8.6. Insurance policies are legal contracts between an insurer and its policyholders. An insurer should not be able to unilaterally alter the terms of a contract by merging with another insurer, mutualising or demutualising or transferring some of its policy liabilities to another insurer. In order to protect the interests of policyholders, legislation should restrict the ability of insurers to transfer their policy liabilities. The supervisory authority must ensure that policyholders' reasonable benefit expectations and existing policy values will not normally be lessened as a result of liability transfer. This should apply whether the transfer involves a single policy or a portfolio or the transaction is considered a part of normal business, a merger or part of a winding-up procedure in a situation where the insurer is no longer financially viable or is insolvent (refer to ICP 16).

### **Changes in control**

#### ***Essential criteria***

- a. The term "control" over an insurer is defined in legislation and it addresses:
  - holding of a defined number or percentage of issued shares or specified financial instruments (such as compulsory convertible debentures) above a designated threshold in an insurer or its intermediate or ultimate beneficial owner
  - voting rights attached to the aforementioned shares or financial instruments
  - power to appoint or remove directors to the board and other executive committees.
- b. The supervisory authority requires that the potential controlling owners apply for approval for the acquisition, or change in control, of the insurers. The insurer must inform the supervisory authority of any acquisitions or changes in control.
- c. The supervisory authority approves any significant increase in shareholdings above the predetermined control levels in an insurer by legal or natural persons, whether obtained individually or in association with others. This also applies to any other interest in that insurer or its intermediate or ultimate beneficial owners.
- d. The requirements in criteria b and c above also refer to the acquisition or change of control where the intermediate or ultimate beneficial owner(s) of an insurer is (are) outside the jurisdiction where the insurer is incorporated. Supervision of changes in control may require coordination with supervisors in other jurisdictions (refer to ICP 5).
- e. The supervisory authority must be satisfied that those seeking control meet the criteria applied during the licensing process. The requirements in ICP 7 – Suitability of persons – will apply to the prospective owners in control of insurers.
- f. The supervisory authority requires that the structures of the financial groups containing potential controlling owners of insurers be sufficiently transparent so that supervision of the insurance group will not be hindered (refer to ICP 17).

- g. The supervisory authority rejects applications of proposed owners to control insurers if facts exist from which it can be deduced that their ownership will be unduly prejudicial to policyholders. The supervisory authority should know who is the intended beneficial owner.
- h. To assess applications for proposed acquisitions or changes in control of insurers the supervisory authority establishes requirements for financial and non-financial resources.

***Advanced criteria***

- i. Upon request insurers provide the supervisory authority with information on their shareholders and any other person directly or indirectly exercising control. The supervisory authority determines the content and format of this information.

**Portfolio transfer**

***Essential criteria***

- j. The supervisory authority requires that insurers get approval from the authority before they transfer all or any part of their insurance business.
- k. The supervisory authority establishes requirements to assess insurers' applications to transfer all or any part of their insurance business.
- l. The supervisory authority requires that the interests of the policyholders of both the transferee and transferor be protected when insurance business is transferred (refer to ICP 15 EC c).

|              |                             |
|--------------|-----------------------------|
| <b>ICP 9</b> | <b>Corporate governance</b> |
|--------------|-----------------------------|

|  |  |
|--|--|
|  | The corporate governance framework recognises and protects rights of all interested parties. The supervisory authority requires compliance with all applicable corporate governance standards. |
|--|--|

**Explanatory note**

9.1. Insurers must be managed prudently. Corporate governance refers to the manner in which boards of directors and senior management oversee the insurers' business. It encompasses the means by which members of the board and senior management are held accountable and responsible for their actions. Corporate governance includes corporate discipline, transparency, independence, accountability, responsibility, fairness and social responsibility. Timely and accurate disclosure on all material matters regarding the insurer, including the financial situation, performance, ownership and governance arrangements, is part of a corporate governance framework. Corporate governance also includes compliance with legal and regulatory requirements.

9.2. The board is the focal point of the corporate governance system. It is ultimately accountable and responsible for the performance and conduct of the insurer. Delegating authority to board committees or management does not in any way mitigate or dissipate the discharge by the board of directors of its duties and responsibilities. In the case of a policy established by the board, the board would need to be satisfied that the policy has been implemented and that compliance has been monitored. Similarly the board needs to be satisfied that applicable laws and regulations have been complied with. The responsibilities of the governing body must be consistent with the rules on governance structure established in the jurisdiction. Where the posts of chairman and chief executive are combined in one

person, the supervisory authority will verify that appropriate controls are in place to ensure that management is sufficiently accountable to the board of directors.

9.3. In most jurisdictions corporate governance rules exist for general purpose corporations; these likely also apply to insurers. Often, however, it is necessary to establish additional requirements, through the insurance legislation, that deal with the matters of specific concern and importance to insurance supervisors. These matters are described in the criteria below. As the supervisory authority may not have the power to specify the details of general corporate governance rules or to enforce compliance, several criteria under this principle refer to the responsibility of the board of directors rather than requirements from the supervisory authority.

#### *Essential criteria*

- a. The supervisory authority requires and verifies that the insurer complies with applicable corporate governance principles.
- b. The board of directors:
  - sets out its responsibilities in accepting and committing to the specific corporate governance principles for its undertaking. Regulations on corporate governance should be covered in general company law and/or insurance law. These regulations should take account of the size, nature and complexity of the insurer.
  - establishes policies and strategies, the means of attaining them, and procedures for monitoring and evaluating the progress toward them. Adherence to the policies and strategies are reviewed regularly, and at least annually.
  - satisfies itself that the insurer is organised in a way that promotes the effective and prudent management of the institution and the board's oversight of that management. The board of directors has in place and monitors independent risk management functions that monitor the risks related to the type of business undertaken. The board of directors establishes audit functions, actuarial functions, strong internal controls and applicable checks and balances.
  - distinguishes between the responsibilities, decision-making, interaction and cooperation of the board of directors, chairman, chief executive and senior management. The board of directors delegates its responsibilities and establishes decision-making processes. The insurer establishes a division of responsibilities that will ensure a balance of power and authority, so that no one individual has unfettered powers of decision.
  - establishes standards of business conduct and ethical behaviour for directors, senior management and other personnel. These include policies on private transactions, self-dealing, preferential treatment of favoured internal and external entities, covering trading losses and other inordinate trade practices of a non-arm's length nature. The insurer has an on-going, appropriate and effective process of ensuring adherence to those standards.
  - appoints and dismisses senior management. It establishes a remuneration policy that is reviewed periodically. This policy is made available to the supervisory authority.
  - collectively ensures that the insurer complies with all relevant laws, regulations and any established codes of conduct (refer to EC f).
  - has thorough knowledge, skills, experience and commitment to oversee the insurer effectively (refer to ICP 7).
  - is not subject to undue influence from management or other parties. The board of directors has access to information about the insurer, and asks and receives additional information and analyses that the board sees fit.
  - communicates with the supervisory authority as required and meets with the supervisory authority when requested.
  - sets out policies that address conflicts of interest, fair treatment of customers and information sharing with stakeholders, and reviews these policies regularly (refer to ICP 25).

- c. Senior management is responsible for:
- overseeing the operations of the insurer and providing direction to it on a day-to-day basis, subject to the objectives and policies set out by the board of directors, as well as to legislation.
  - providing the board of directors with recommendations, for its review and approval, on objectives, strategy, business plans and major policies that govern the operation of the insurer.
  - providing the board with comprehensive, relevant and timely information that will enable it to review business objectives, business strategy and policies, and to hold senior management accountable for its performance.

***Advanced criteria***

- d. The board of directors may establish committees with specific responsibilities like a compensation committee, audit committee or risk management committee.
- e. The remuneration policy for directors and senior management has regard to the performance of the person as well as that of the insurer. The remuneration policy should not include incentives that would encourage imprudent behaviour.
- f. The board of directors identifies an officer or officers with responsibility for ensuring compliance with relevant legislation and required standards of business conduct and who reports to the board of directors at regular intervals (refer to EC b).
- g. When a “responsible actuary” is part of the supervisory process, the actuary has direct access to the board of directors or a committee of the board. The actuary reports relevant matters to the board of directors on a timely basis.

**ICP 10 Internal control**

The supervisory authority requires insurers to have in place internal controls that are adequate for the nature and scale of the business. The oversight and reporting systems allow the board and management to monitor and control the operations.

**Explanatory note**

10.1. The purpose of internal control is to verify that:

- the business of an insurer is conducted in a prudent manner in accordance with policies and strategies established by the board of directors (refer to ICP 9)
- transactions are only entered into with appropriate authority
- assets are safeguarded (refer to ICP 21)
- accounting and other records provide complete, accurate, verifiable and timely information
- management is able to identify, assess, manage and control the risks of the business and hold sufficient capital for these risks (refer to ICP 18 and 23).

10.2. A system of internal control is critical to effective risk management and a foundation for the safe and sound operation of an insurer. It provides a systematic and disciplined approach to evaluating and improving the effectiveness of the operation and assuring compliance with laws and regulations. It is the responsibility of the board of directors to develop a strong internal control culture within its organisation, a central feature of which is the establishment of systems for adequate communication of information between levels of management.

10.3. It is an essential element of an internal control system that the board of directors receive regular reporting on the effectiveness of the internal control. Any identified weakness should be reported to the board of directors as soon as possible so appropriate action can be taken.

***Essential criteria***

- a. The supervisory authority reviews the internal controls and checks their adequacy to the nature and the scale of the business and requires strengthening of these controls where necessary. The board of directors is ultimately responsible for establishing and maintaining an effective internal control system.
- b. The framework for internal controls within the insurer includes arrangements for delegating authority and responsibility, and the segregation of duties. The internal controls address checks and balances; e.g. cross-checking, dual control of assets, double signatures (refer to ICP 9 EC b).
- c. The internal and external audit, actuarial and compliance functions are part of the framework for internal control, and must test adherence to the internal controls as well as to applicable laws and regulations.
- d. The board of directors must provide suitable prudential oversight and establish a risk management system that includes setting and monitoring policies so that all major risks are identified, measured, monitored and controlled on an on-going basis. The risk management systems, strategies and policies are approved and periodically reviewed by the board of directors (refer to ICP 18).
- e. The board of directors provides suitable oversight of market conduct activities.
- f. The board of directors should receive regular reporting on the effectiveness of the internal controls. Internal control deficiencies, either identified by management, staff, internal audit or other control personnel, are reported in a timely manner and addressed promptly.
- g. The supervisory authority requires that internal controls address accounting procedures, reconciliation of accounts, control lists and information for management.
- h. The supervisory authority requires oversight and clear accountability for all outsourced functions as if these functions were performed internally and subject to the normal standards of internal controls.
- i. The supervisory authority requires the insurer to have an on-going internal audit function of a nature and scope appropriate to the business. This includes ensuring compliance with all applicable policies and procedures and reviewing whether the insurer's policies, practices and controls remain sufficient and appropriate for its business.
- j. The supervisory authority requires that an internal audit function:
  - has unfettered access to all the insurer's business lines and support departments
  - assesses outsourced functions
  - has appropriate independence, including reporting lines to the board of directors
  - has status within the insurer to ensure that senior management reacts to and acts upon its recommendations
  - has sufficient resources and staff that are suitably trained and have relevant experience to understand and evaluate the business they are auditing

- employs a methodology that identifies the key risks run by the institution and allocates its resources accordingly (refer to ICP 18).

- k. The supervisory authority has access to reports of the internal audit function.
- l. Where the appointment of an actuary is called for by applicable legislation or by the nature of the insurer's operations, the supervisory authority requires that actuarial reports be made to the board and to management.

## 5. On-going supervision

### ICP 11 Market analysis

Making use of all available sources, the supervisory authority monitors and analyses all factors that may have an impact on insurers and insurance markets. It draws conclusions and takes action as appropriate.

#### Explanatory note

11.1. In order to achieve its objectives, the supervisory authority supervises the financial soundness of individual insurers and contributes to financial stability of the insurance market. Both require an analysis of individual insurers and insurance groups as well as the market and the environment in which they operate.

11.2. In today's globalised financial markets and rapidly integrating financial systems, economic developments and policy decisions of one jurisdiction may affect many other jurisdictions. Similarly, developments in the economy as a whole, or in one part of the financial sector, may impact the business operations and financial stability of the insurance market. To enable an assessment of financial data, it will be necessary to have an understanding of the basis of financial reporting in relevant jurisdictions.

11.3. In-depth market analysis helps identify risks and vulnerabilities, supports prompt supervisory intervention as referred in ICP 14 and strengthens the supervisory framework with a view to reducing the likelihood or severity of future problems. It is recognised that in-depth market analysis requires skilled resources.

11.4. A quantitative analysis of the market could include, for example, developments in the financial markets generally; the number of insurers and reinsurers subdivided by ownership structure whether a branch, domestic or foreign; the number of insurers and reinsurers entering and exiting the market; market indicators such as premiums, balance sheet totals and profitability; investment structure; new product developments and market share; distribution channels; and use of reinsurance.

11.5. A qualitative analysis could include, for example, reporting on general developments which may impact insurance markets, companies and clients; new or forthcoming financial sector and other relevant legislation; developments in supervisory practices and approaches; and reasons for market exits.

#### *Essential criteria:*

- a. The supervisory authority conducts regular analysis of market conditions.

- b. The market analysis not only includes past developments and the present situation, but also aims to identify trends and possible future scenarios and issues, so that the supervisory authority is well prepared to take action at an early stage, if required.
- c. The market analysis is both quantitative and qualitative and makes use of both public and confidential sources of information.
- d. The supervisory authority or others, such as the insurance industry, publish aggregated market data that is readily and publicly available to the insurance industry and other interested parties.
- e. The supervisory authority requires market-wide systematic reporting to analyse and monitor particular market-wide events of importance for the financial stability of insurance markets.

***Advanced criteria:***

- f. Insofar as international relationships affect internal insurance and financial markets, the analysis is not limited to the home market, but also includes developments elsewhere.
- g. The supervisory authority monitors trends that may have an impact on the financial stability of insurance markets. It assesses whether macro-economic risks and vulnerabilities are adversely impinging on prudential safeguards, financial stability or consumer interests.

|  |
|--|
| <p><b>ICP 12      Reporting to supervisors and off-site monitoring</b></p> <p style="text-align: center;">The supervisory authority receives necessary information to conduct effective off-site monitoring and to evaluate the condition of each insurer as well as the insurance market.</p> |
|--|

**Explanatory note**

12.1. It is essential for the supervisory authority to receive information necessary to conduct effective off-site monitoring which can often identify potential problems, particularly in the interval between on-site inspections, thereby providing early detection and prompting corrective action before problems become more serious.

12.2. The supervisory authority decides what information it requires, in what form, from whom, and with what frequency. The reporting requirements are a reflection of the supervisory needs, and will thus vary according to overall market structure and situation. They also reflect the situation at individual insurers and the way they control their risks (e.g., asset/liability management, reinsurance policy.). Information should be both current and prospective in nature. In setting the requirements the supervisory authority should strike a balance between the need for information for supervisory purposes and the administrative burden it puts on insurers.

12.3. Reporting requirements should apply to all insurers licensed in a jurisdiction and form the general basis for off-site analysis. The reporting requirements should be reviewed periodically. Additional information may be requested from specific insurers on a case-by-case basis. New developments may require the supervisory authority to carry out market-wide off-site analyses, which will require having insurers to submit information on an ad-hoc basis.

12.4. In setting the requirements, the supervisory authority may make a distinction between the standards applied to reports prepared for disclosure to policyholders and investors, and those applied for the supervisory authority.



12.5. In setting the requirements, the supervisory authority may make a distinction between the financial reports and calculations prepared for companies incorporated in its jurisdiction, and branch operations in its jurisdiction of companies incorporated in another jurisdiction.

***Essential criteria:***

- a. The supervisory authority:
  - sets the requirements for the submission of regular and systematic financial and statistical information, actuarial reports and other information from all insurers licensed in the jurisdiction
  - defines the scope and frequency of those reports and information, including any requirement that reports and information be audited
  - requires, as a minimum, an audit opinion should be provided annually (refer to ICP 1 EC e)
  - requests more frequent and more detailed additional information whenever there is a need.
- b. If making a distinction between the financial reports and requirements of companies incorporated in the jurisdiction and branches, or between private entities and government-sponsored insurers that compete with private enterprises, the supervisory authority should not distort the market in favour of or against any particular form of enterprise.
- c. The supervisory authority:
  - requires insurers to submit information about their financial condition and performance on both a solo and a group-wide basis. It may request and obtain financial information on any subsidiary of the supervised entity.
  - sets out the principles and norms regarding accounting and consolidation techniques to be used. The valuation of assets and liabilities should be consistent, realistic, and prudent (refer to ICP 21 EC b).
  - requires insurers to report any off-balance sheet exposures.
  - requires insurers to report on their outsourced functions.
  - requires that the appropriate level of an insurer's senior management is responsible for the timing and accuracy of these returns.
  - requires that inaccurate information be corrected and has the authority to impose sanctions for deliberate misreporting.
  - based on this information, maintains a framework for on-going monitoring of the financial condition and performance of the insurers.

***Advanced criteria***

- d. From time to time, the supervisory authority reviews its regular and systematic reporting requirements to ensure they still serve their intended aims and are carried out in an efficient and effective manner.
- e. The supervisory authority requires insurers to report promptly material changes that affect the evaluation of their condition.

**ICP 13 On-site inspection**

The supervisory authority carries out on-site inspections to examine the business of an insurer and its compliance with legislation and supervisory requirements.

## Explanatory note

13.1. Whether performed by the staff of the supervisory authority or other suitably qualified specialists, on-site inspection is an important part of the supervisory process, closely related to the off-site monitoring process. It provides information that supplements the analysis of the reporting to supervisory authorities sent by the insurer. On-site inspection, however, also needs the support of market information and statistics derived from the analysis of the annual accounts and returns.

13.2. Through on-site inspections the supervisory authority is able to verify or capture reliable data and information to assess and analyse an insurer's current and prospective solvency. On-site inspection enables the supervisor to obtain information and detect problems that cannot be easily obtained or detected through on-going monitoring. In particular, on-site inspections allow the supervisor to identify problems or irregularities in a range of areas, including asset quality, accounting and actuarial practices, internal controls (including those dealing with information technology and outsourcing), quality of underwriting (both the prudence of the underwriting policy and the effectiveness of its implementation in practice), valuation of technical provisions<sup>4</sup>, strategic and operational direction, reinsurance, and risk management.

13.3. On-site inspections enhance the supervisor's ability to assess the competence of the managers of insurers. It is also an effective way for supervisors to assess the management's decision-making processes and internal controls. It provides supervisors the opportunity to analyse the impact of specific regulations and, more generally, to gather information for benchmarking.

13.4. The criteria envisage that on-site inspection may be carried out in a manner that is either "full scale" or "on a focussed basis." Both forms of inspection need to be conducted by skilled staff that can evaluate and analyse the information that they obtain during the inspection. Usually the supervisory authority provides guidance on the scope and procedures for on-site inspections. However, staff performing inspections should use their investigative and technical skills when forming views about the information they obtain.

13.5. On-site inspection can assist in assessing the risks to which a firm is exposed. A full-scale on-site inspection includes, at a minimum, the following activities:

- evaluation of the management and internal control system
- analysis of the nature of the insurer's activities, e.g. the type of business written
- evaluation of the technical conduct of insurance business or an evaluation of the organisation and the management of the insurer, the commercial policy and the reinsurance cover and its security
- analysis of the relationships with external entities, such as through outsourcing or with respect to other companies in the same group
- assessment of the insurer's financial strength, notably the technical provisions
- evaluation of compliance with corporate governance requirements.

13.6. A full-scale on-site inspection of market conduct issues includes, at a minimum, the following activities:

- checking the sufficiency and adequacy of the information given to consumers
- reviewing the timing of payments

---

<sup>4</sup> The term "technical provisions" is used throughout this document. Some jurisdictions use the term "policy liabilities" instead. The meaning is the same, i.e., amount set aside on the balance sheet to meet liabilities arising out of insurance contracts, including claims provision (whether reported or not), provision for unearned premiums, provision for unexpired risks, life assurance provision and other liabilities related to life insurance contracts (e.g. premium deposits, savings accumulated over the term of with-profit policies) (source: IAIS Glossary of Terms).

- reviewing the frequency and nature of litigation
- assessing observance of the market conduct standards and consumer regulations (refer to ICP 25 and 26).

13.7. Effective inspections may need to include access to outsourced service providers or other parties to ensure that the inspection adequately addresses insurers who transfer functions and information outside the company. Where another authority supervises the outsourced service provider supervisory actions should be coordinated (refer to ICP 5).

13.8. The frequency of on-site inspections will take account of the risk profile of the insurer as it appears from previous on-site inspections and off-site monitoring; an additional factor may be the relative importance of the insurer in the market.

***Essential criteria:***

- a. By law, the supervisory authority has wide-ranging powers to conduct on-site inspections and gather information deemed necessary to perform its duties.
- b. The supervisory authority, external auditors or other suitably qualified parties verify information in regulatory returns periodically through on-site inspections. Where parties other than the supervisory authority verify information, then arrangements for communication with the supervisory authority should be established.
- c. The supervisory authority may conduct on-site inspections on either a full scale, or a focussed basis investigating areas of specific concern.
- d. The supervisory authority promptly discusses findings and any need for corrective action with the insurer and obtains appropriate feedback from the insurer.
- e. The supervisory authority follows up with the insurer to ensure that any required action has been taken.
- f. The supervisory authority can extend on-site inspections to obtain information from intermediaries and companies that have accepted functions outsourced by the supervised insurer.

**ICP 14 Preventive and corrective measures**

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

**Explanatory note**

14.1. Where insurers fail to meet supervisory requirements or where their continued solvency comes into question, the supervisory authority must intervene to protect policyholders. To do so, the supervisor authority needs to have the legal and operational capacity to bring about timely corrective action. Depending on the nature of the problem detected, a graduated response may be required. In instances where the detected problem is relatively minor, informal action such as an oral or written communication to management may be sufficient. In other instances, more formal action may be necessary.

***Essential criteria:***

- a. The supervisory authority has available and makes use of adequate instruments to enable timely preventive and corrective measures if an insurer fails to operate in a manner that is consistent with sound business practices or regulatory requirements.
- b. There should be a progressive escalation of action or remedial measures if the problems become worse or if management of the insurer ignores more informal requests from the supervisory authority to take corrective action.
- c. The supervisory authority has the capacity and standing to communicate with insurers, and insurers comply with such communications, to ensure that relatively minor preventive or corrective measures are taken.
- d. If necessary the supervisory authority requires the insurer to develop an acceptable plan for correction of problems. Corrective plans include agreed and acceptable steps to be taken to resolve the issues raised and an acceptable timetable.
- e. The supervisory authority initiates measures designed to prevent a breach of the legislation from occurring, and promptly and effectively deals with non-compliance with regulations that could put policyholders at risk or impinge on any other of the authority's objectives.

**ICP 15      Enforcement or sanctions**

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

**Explanatory note**

15.1. The supervisory authority must have the power to take remedial action in a timely manner where problems involving licensed insurers are identified. The decision-making lines of the supervisory authority should be structured so that action can be taken immediately in the case of an emergency situation (refer to ICP 4 EC e).

15.2. The supervisory authority must have a range of actions available in order to apply appropriate enforcement or sanctions where problems are encountered. Powers should be set out in legislation and may include:

- restricting business activities
- stopping the writing of new business
- withholding approval for new activities or acquisitions
- directing the insurer to stop practices that are unsafe or unsound
- putting assets of the insurer in trust or restricting disposal of those assets
- revoking the licence of an insurer
- removing directors and managers
- barring individuals from the business of insurance.

15.3. In some cases it may be appropriate to apply punitive sanctions against insurers or individuals. Provided that the policyholders are not put at greater risk, provisions would normally apply to such situations that would permit a right of appeal of decisions. For actions taken in good faith while discharging their duties the law provides legal protection to the supervisory authority and its staff against lawsuits (refer to ICP 3).

15.4. This principle is directed at the overall protection of policyholders and the observance of requirements. Matters involving individual customers are subject to ICP 25.

***Essential criteria:***

- a. The supervisory authority can issue formal directions to companies to take particular actions or to desist from taking particular actions. Failure to comply with a formal direction issued by the supervisory authority has serious consequences for those that take such a step.
- b. The supervisory authority has the power to prevent the insurer issuing new policies.
- c. The supervisory authority can arrange for compulsory transfer of the obligations under the policies from a failing insurer to another insurer that accepts this transfer (refer to ICP 8 EC 1).
- d. The supervisory authority can require capital levels to be increased, restrict or suspend dividend or other payments to shareholders, restrict asset transfers and restrict an insurer's purchase of its own shares. It can also initiate action to restrict the ownership or activities of a subsidiary where, in its opinion, such activities jeopardise the financial situation of the insurer.
- e. The supervisory authority has effective means to address management problems, including the power to have controlling owners, directors, and managers replaced or their powers restricted. More generally the supervisory authority in extreme cases, imposes conservatorship over an insurer that is failing to meet prudential or other requirements. The supervisory authority has the power to take control of the insurer, or to appoint other specified officials or receivers for the task, and to make such arrangements for the benefit of the policyholders as are necessary.
- f. Once action has been taken or remedial measures have been imposed, the supervisory authority periodically checks to determine that the insurer is complying with the measures.
- g. The insurance legislation provides for sanctions by way of fines against individuals and insurers where the provisions of the legislation are breached.
- h. The insurance legislation provides for sanctions against individuals who withhold information from the supervisory authority, provide information that is intended to mislead the supervisory authority or fail to provide information to the supervisory authority in a timely fashion.
- i. Individuals can be barred from acting in responsible capacities in the future.
- j. The process of applying sanctions should not delay necessary preventive and corrective measures and enforcement.
- k. The supervisory authority takes action to withdraw the license of an insurer where appropriate.
- l. The supervisory authority has the powers to protect one or more insurers within its jurisdiction that belong to a group from the financial difficulties in other parts of the group.
- m. The supervisory authority, or another responsible body in the jurisdiction, takes action to enforce all the sanctions noted above.
- n. The supervisory authority ensures consistency in the way insurers are sanctioned, so that similar violations and weaknesses attract similar preventive and corrective measures.

- o. The supervisory authority or other authority takes action against those individuals or entities that are operating an insurance business without a licence.

#### **ICP 16 Winding-up and exit from the market**

The legal and regulatory framework defines a range of options for the orderly exit of insurers from the marketplace. It defines insolvency and establishes the criteria and procedure for dealing with insolvency. In the event of winding-up proceedings, the legal framework gives priority to the protection of policyholders.

#### **Explanatory note**

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

16.2. The legislation should establish the priority that policyholders receive in winding-up an insurer. However, it is also common in many jurisdictions that priority is given to other stakeholders, such as employees or the fiscal authorities. In some jurisdictions, a policyholder protection fund provides additional or alternative protection. Some jurisdictions may decide that protection provided through a policyholder protection fund is not necessary for commercial policyholders.

#### ***Essential criteria:***

- a. The legal and regulatory framework provides for the determination of the point at which it is no longer permissible for an insurer to continue its business.
- b. The procedures for dealing with insolvency and the winding-up of the insurer are clearly set forth in the law.
- c. A high legal priority is given to the protection of the rights and entitlements of policyholders and other policy beneficiaries in the event of an insurer becoming insolvent and winding-up. This priority ensures that, as far as is practical, there is limited disruption to the provision of benefits to policyholders.

#### **ICP 17 Group-wide supervision**

The supervisory authority supervises its insurers on a solo and a group-wide basis.

#### **Explanatory note**

17.1. Supervision of insurers, who are part of a wider insurance group or conglomerate, whether domestic or international, should not be limited to the solo supervision of that insurer. The operations of other group companies, including any holding companies if applicable, are taken into account in assessing the totality of the risk exposures of the insurers, insurance groups and conglomerates. The fact that such an insurer is part of a group generally alters, often considerably, its risk profile, its financial position, the role of its management, and its business strategy. As a consequence, there should be legal provisions and effective supervision that adequately meet the changed profile of the insurer, ensuring adequate group wide assessment and supervisory action as appropriate.

17.2. As a first step, there should be legal certainty for all parties involved about what constitutes an insurance group or conglomerate. For entities that are considered to be part of such a group, a group mapping exercise should be undertaken that delineates the group structure, and identifies the supervisory authorities involved. Supervisory tasks for the group and the constituent parts should be agreed upon by the supervisors involved or may be set out in legislation. This may call for further co-operation agreements between the various supervisory authorities often including supervisory authorities from different jurisdictions and financial sectors.

17.3. Group-wide assessment and supervision should not be limited to financial indicators such as capital adequacy and risk concentration, but also the management structure, fit and proper testing, and legal issues. The groups should have information systems in place not only to serve their internal information needs, but also to provide all information that the supervisory authority may require in an adequate and timely manner.

17.4. The effective supervision of groups may require effort to ensure that the necessary supervisory tools such as information collection and on-site inspections are able to address group-wide issues effectively.

***Essential criteria:***

- a. What constitutes an insurance group and financial conglomerate is clearly defined so that supervisors and insurers can determine:
  - which groups are considered to be insurance groups or financial conglomerates
  - which group or groups an insurer belongs to
  - the scope of the supervision.
- b. The supervisory authority ensures effective and efficient group-wide supervision. The supervisory authorities co-operate to avoid unnecessary duplication.
- c. Where different supervisory authorities are responsible for different parts of a group or conglomerate appropriate co-operation and co-ordination exists. The supervisory responsibilities of each authority are well-defined and leave no supervisory gaps.
- d. At a minimum, group-wide supervision of insurers which are part of insurance groups or financial conglomerates includes, as a supplement to solo supervision, at a group level, and intermediate level as appropriate, adequate policies on and supervisory oversight of:
  - group structure and interrelationships, including ownership and management structure
  - capital adequacy
  - reinsurance and risk concentration
  - intra-group transactions and exposures, including intra-group guarantees and possible legal liabilities
  - internal control mechanisms and risk management processes, including reporting lines and fit and proper testing of senior management.
- e. Host supervisory authorities avoid uncooperative behaviour with home supervisory authorities so as not to hinder effective supervision of groups and conglomerates (refer to ICP 5 EC i).
- f. The supervisory authority requires that insurance groups and financial conglomerates have reporting systems in place that adequately meet the supervisory information demands.

- g. The supervisory authority may deny or withdraw the license when the organisational (or group) structure hinders effective supervision (refer to ICP 6 and ICP 15).

## 6. Prudential requirements

15. This section sets out six principles addressing prudential requirements. Their common goal is to ensure that insurers have the ability under all reasonably foreseeable circumstances to fulfil their obligations as they fall due.

### ICP 18 Risk assessment and management

The supervisory authority requires insurers to recognise the range of risks that they face and to assess and manage them effectively.

#### Explanatory note

18.1. An insurer should identify, understand, and manage the significant risks that it faces. Effective and prudent risk management systems appropriate to the complexity, size and nature of the insurer's business should identify and measure against risk tolerance limits the risk exposure of the insurer on an on-going basis in order to indicate potential risks as early as possible. This may include looking at risks by territory or by line of business.

18.2. Some risks are specific to the insurance sector, such as underwriting risks and risks related to the evaluation of technical provisions. Other risks are similar to those of other financial institutions, for example market (including interest rate), operational, legal, organisational and conglomerate risks (including contagion, correlation and counter-party risks).

18.3. Supervisors play a critical role in the risk management process by reviewing the monitoring and controls exercised by the insurer. The supervisory authority develops prudential regulations and requirements to contain these risks. While the supervisor puts such requirements in place with the intention of ensuring enhanced practices by insurers, the ultimate responsibility for the development of best practices and the proper operation of the insurer must always rest with the board of directors.

#### *Essential criteria*

- a. The supervisory authority requires and checks that insurers have in place comprehensive risk management policies and systems capable of promptly identifying, measuring, assessing, reporting and controlling their risks (refer to ICP 10 EC d).
- b. The risk management policies and risk control systems are appropriate to the complexity, size and nature of the insurer's business. The insurer establishes an appropriate tolerance level or risk limit for material sources of risk.
- c. The risk management system monitors and controls all material risks.
- d. Insurers regularly review the market environment in which they operate, draw appropriate conclusions as to the risks posed and take appropriate actions to manage adverse impacts of the environment on the insurer's business.



### *Advanced criteria*

- e. Larger insurers establish a risk management function and a risk management committee.

### **ICP 19 Insurance activity**

Since insurance is a risk taking activity, the supervisory authority requires insurers to evaluate and manage the risks that they underwrite, in particular through reinsurance, and to have the tools to establish an adequate level of premiums.

### **Explanatory note**

19.1. Insurers take on risks and manage them through a range of techniques including pooling and diversification. Every insurer should have an underwriting policy that is approved and monitored by the board of directors.

19.2. Insurers use actuarial, statistical, or financial methods for estimating liabilities and determining premiums. If these amounts are materially understated, the consequences for the insurer can be significant and in some cases fatal. In particular, premiums charged could be inadequate to cover the risk and costs, insurers may pursue lines of business that are not profitable, and liabilities may be understated, masking the true financial state of the insurer. There is a need to ensure that embedded options have been identified, properly priced and an appropriate reserve has been established.

19.3. Insurers use a number of tools to mitigate and diversify the risks they assume. The most important tool to transfer risk is reinsurance. An insurer should have a reinsurance strategy, approved by its board, that is appropriate to its overall risk profile and its capital. The reinsurance strategy will be part of the insurer's overall underwriting strategy.

### *Essential criteria*

- a. The supervisory authority requires insurers to have in place strategic underwriting and pricing policies approved and reviewed regularly by the board of directors.
- b. The supervisory authority checks that insurers evaluate the risks that they underwrite and establish and maintain an adequate level of premiums. For this purpose, insurers should have systems in place to control their expenses related to premiums and claims, including claims handling and administration expenses. These expenses should be monitored by management on an on-going basis.
- c. The supervisory authority is able to review the methodology used by the insurer to set premiums to determine that they are established on reasonable assumptions to enable the insurer to meet its commitments.
- d. The supervisory authority requires that the insurer has a clear strategy to mitigate and diversify risks by defining limits on the amount of risk retained and taking out appropriate reinsurance cover or using other risk transfer arrangements consistent with its capital position. This strategy is an integral part of the insurer's underwriting policy and must be approved and regularly monitored and reviewed by the board of directors.
- e. The supervisory authority reviews reinsurance arrangements to check that they are adequate and that the claims held by insurers on their reinsurers are recoverable. This includes that:

- the reinsurance programme provides coverage appropriate to the level of capital of the insurer (taking into account the real transfer of risk) and the profile of the risks it underwrites
- the reinsurer’s protection is secure. This might be addressed through different means, such as relying on a system of direct supervision of reinsurers or obtaining collateral (including trusts, letters of credit or funds withheld).

f. The supervisory authority checks that risk transfer instruments are properly accounted for in order to give a true and fair view of the insurer’s risk exposure.

## **ICP 20 Liabilities**

The supervisory authority requires insurers to comply with standards for establishing adequate technical provisions and other liabilities, and making allowance for reinsurance recoverables. The supervisory authority has both the authority and the ability to assess the adequacy of the technical provisions and to require that these provisions be increased, if necessary.

### **Explanatory note**

20.1. An insurer must identify and quantify its existing and anticipated obligations. The establishment of sufficient technical provisions, that is the amount set aside on the balance sheet to meet obligations arising out of insurance contracts (including any related administration expenses, embedded options, policyholder dividends or bonuses and taxes) is a cornerstone of a sound capital adequacy and solvency regime.

20.2. Standards should be defined to be followed by the insurers in setting up their liabilities and, in particular, their technical provisions. These standards should address what is to be included as liabilities; for example, claims provisions – including provisions for claims incurred but not reported, provisions for unearned premiums, provisions for unexpired risks, life insurance provisions and any other liabilities or technical provisions. These standards should also be consistent with other components of the solvency regime. The standards should ensure that technical provisions are sufficient to cover all expected and some unexpected claims and expenses, make use of reliable and objective methods, and allow a comparison across insurers. The supervisors must have both the power and the ability to check the adequacy of the technical provisions vis-à-vis the established standards and to require the provisions to be increased if, in the supervisor’s opinion, these are not sufficient. This part of the supervisory process requires the use of appropriate actuarial skills.

### ***Essential criteria***

- a. Legal provisions are in place for establishing adequate technical provisions and other liabilities based on sound accounting and actuarial principles.
- b. The supervisory authority prescribes or agrees to standards for establishing technical provisions and other liabilities.
- c. The supervisory authority in developing the standards considers:
  - what is to be included as a liability
  - the procedure and the internal control system that are in place to ensure reliable data (refer to ICP 10)
  - the methods and assumptions for assessing, on a reliable, objective, transparent and prudent basis, technical provisions to cover all expected and some unexpected claims and expenses.

- d. The supervisory authority reviews the sufficiency of the technical provisions through off-site monitoring and on-site inspection (refer to ICPs 12 and 13).
- e. The supervisory authority requires the technical provisions to be increased if they are not sufficient.
- f. The supervisory authority ensures that standards stipulate:
  - general limits for the valuation of the amounts recoverable under reinsurance arrangements with a given reinsurer for solvency purposes, taking into account the ultimate collectability and the real transfer of risk
  - sound accounting principles for the booking of the amounts recoverable under reinsurance arrangements
  - the credit for technical provisions for amounts recoverable under reinsurance arrangements. In that case, the amount recoverable is disclosed in the financial statement of the insurer by reporting the respective gross and net figures in the accounts.

***Advanced criteria***

- g. The supervisory authority requires that insurers undertake regular stress testing for a range of adverse scenarios in order to assess the adequacy of capital resources in case technical provisions have to be increased (refer to ICP 21 AC k and ICP 23 AC j).

**ICP 21 Investments**

The supervisory authority requires insurers to comply with standards on investment activities. These standards include requirements on investment policy, asset mix, valuation, diversification, asset-liability matching, and risk management.

**Explanatory note**

21.1. Insurers must manage their investments in a sound and prudent manner. An investment portfolio carries a range of investment-related risks that might affect the coverage of technical provisions and the solvency margin. Insurers need to identify, measure, report and control the main risks.

21.2. For insurers in many jurisdictions concentration risk arising from the limited availability of suitable domestic investment vehicles is a real problem. By contrast, international insurers' investment strategies are potentially complex because often they need to manage and match assets and liabilities in a number of currencies and different markets. In addition, the need for liquidity resulting from potential large-scale payments may further complicate an insurer's investment strategy.

21.3. The supervisory authority ensures that standards are established for insurers in managing their investment portfolios and inherent risks. The supervisory authority needs to have both the authority and ability to assess these risks and their potential impact on technical provisions and solvency. However, the detailed formulation of an insurer's investment management policy and internal risk control methodology is the responsibility of the board of directors.

***Essential criteria***

- a. Requirements regarding the management of investments are in place, either in the law or in supervisory rules. These requirements address, but may not be limited to, the following:
  - the mixture and diversification by type

- limits or restrictions on the amount that may be held in particular types of financial instruments, property, and receivables
  - the safekeeping of assets
  - the appropriate matching of assets and liabilities
  - the level of liquidity.
- b. Investments are valued according to a method prescribed by or acceptable to the supervisory authority.
- c. The supervisory authority requires insurers to have in place an overall strategic investment policy, approved and reviewed annually by the board of directors, that addresses the following main elements:
- the risk profile of the insurer
  - the determination of the strategic asset allocation, that is, the long-term asset mix over the main investment categories
  - the establishment of limits for the allocation of assets by geographical area, markets, sectors, counterparties and currency
  - the extent to which the holding of some types of assets is restricted or disallowed, for example illiquid or volatile assets or derivatives
  - the conditions under which the insurer can pledge or lend assets
  - an overall policy on the use of financial derivatives and structured products that have the economic effect of derivatives (refer to ICP 22)
  - clear accountability for all asset transactions and associated risks.
- d. The risk management systems must cover the risks associated with investment activities that might affect the coverage of technical provisions and/or solvency margins (capital). The main risks include:
- market risk
  - credit risk
  - liquidity risk
  - failure in safe keeping of assets (including the risk of inadequate custodial agreements).
- e. The supervisory authority checks that insurers have in place adequate internal controls to ensure that assets are managed in accordance with the overall investment policy, as well as in compliance with legal, accounting, and regulatory requirements. These controls should ensure that investment procedures are documented and properly overseen. Normally the functions responsible for measuring, monitoring, settling and controlling asset transactions are separate from the front office functions (refer to ICP 10).
- f. The supervisory authority requires that oversight of, and clear management accountability for, an insurer's investment policies and procedures remain ultimately with the board of directors, regardless of the extent to which associated activities and functions are delegated or outsourced.
- g. The supervisory authority requires that key staff involved with investment activities have the appropriate levels of skills, experience and integrity.
- h. The supervisory authority requires that insurers have in place rigorous audit procedures that include full coverage of their investment activities to ensure the timely identification of internal control weaknesses and operating system deficiencies. If the audit is performed internally it should be independent of the function being reviewed.

- i. The supervisory authority requires that insurers have in place effective procedures for monitoring and managing their asset/liability position to ensure that their investment activities and asset positions are appropriate to their liability and risk profiles.
- j. The supervisory authority requires that insurers have in place contingency plans to mitigate the effects of deteriorating conditions.

***Advanced criteria***

- k. The supervisory authority requires that insurers undertake regular stress testing for a range of market scenarios and changing investment and operating conditions in order to assess the appropriateness of asset allocation limits (refer to ICP 20 AC g and ICP 23 AC j).

**ICP 22 Derivatives and similar commitments**

The supervisory authority requires insurers to comply with standards on the use of derivatives and similar commitments. These standards address restrictions in their use and disclosure requirements, as well as internal controls and monitoring of the related positions.

**Explanatory note**

22.1. A derivative is a financial asset or liability whose value depends on (or is derived from) other assets, liabilities or indices (the "underlying asset"). Derivatives are financial contracts and include a wide assortment of instruments, such as forwards, futures, options, warrants, and swaps. These features can be embedded in hybrid instruments (e.g., a bond whose maturity value is tied to an equity index is a hybrid instrument that contains a derivative). Insurers choosing to engage in derivative activities should clearly define their objectives, ensuring that these are consistent with any legislative restrictions.

22.2. Given the nature of insurance operations, derivatives should be used preferably as a risk mitigation mechanism. Supervisory authorities may restrict the use of derivatives to the reduction of investment risk or efficient portfolio management. Derivatives should be considered in the context of a prudent overall asset/liability management strategy.

22.3. This principle also applies to financial instruments that have the economic effect of derivatives and could apply to commodity derivatives, where insurers are permitted to engage in these transactions. Where a jurisdiction completely prohibits the use of derivatives and similar commitments then the assessment criteria clearly do not apply. The prohibition of the use of derivatives is particularly appropriate where a jurisdiction does not fully observe the conditions for effective supervision (refer to ICP 1).

22.4. The criteria of transparent and structured decision-making procedures of policy-setting, execution, monitoring, reporting and control apply equally to similar commitments that are not derivatives transactions but which may be included in some jurisdictions as 'off-balance sheet' items. Equivalent requirements and controls should be in place for commitments transacted through special purpose vehicles.

22.5. Derivatives, used appropriately, can be useful tools in the reduction of portfolio risk of insurers. In monitoring the activities of insurers involved in derivatives, the supervisory authority must satisfy itself that insurers have the ability to recognise, measure, and prudently manage the risks associated with their use. The supervisory authority should obtain sufficient information on insurers' policies and

procedures on the use of derivatives and may request information on the purpose for which particular derivatives are to be used and the rationale for undertaking particular transactions.

#### ***Essential criteria***

- a. Requirements regarding the use of derivatives are in place, either in the law or in supervisory rules. The requirements consider the risks in the use of derivatives and similar commitments.
- b. The supervisory authority establishes disclosure requirements for derivatives and similar commitments.
- c. The supervisory authority requires the board of directors to satisfy itself that collectively the board has sufficient expertise to understand the important issues related to the use of derivatives, and that all individuals conducting and monitoring derivatives activities are suitably qualified and competent.
- d. The supervisory authority requires insurers using derivatives to have in place an appropriate policy for their use that must be approved and reviewed annually by the board of directors. This policy should be consistent with the insurer's activities, its overall strategic investment policy and asset/liability management strategy, and its risk tolerance. It addresses at least the following elements:
  - the purposes for which derivatives can be used
  - the establishment of appropriately structured exposure limits for derivatives taking into account the purpose of their use and the uncertainty caused by market, credit, liquidity, operations and legal risk
  - the extent to which the holding of some types of derivatives is restricted or not authorised; for example, where the potential exposure cannot be reliably measured, the closing out or disposal of the derivative could be difficult due to its lack of marketability (as may be the case with over-the-counter instruments) or the illiquidity of the market, or where independent (i.e. external) verification of pricing is not available
  - the delineation of lines of responsibility and a framework of accountability for derivatives transactions.
- e. The supervisory authority requires that insurers have in place risk management systems, covering the risks from derivatives activities to ensure that the risks arising from all derivatives transactions undertaken by the insurer can be:
  - analysed and monitored individually and in aggregate
  - monitored and managed in an integrated manner with similar risks arising from nonderivatives activities so that exposures can be regularly assessed on a consolidated basis.
- f. The supervisory authority requires that insurers have in place adequate internal controls to ensure that derivatives activities are properly overseen and that transactions have been entered into only in accordance with the insurer's approved policies and procedures, and legal and regulatory requirements. These controls ensure appropriate segregation between those who measure, monitor, settle and control derivatives and those who initiate transactions (refer to ICP 10).
- g. The supervisory authority requires that insurers have in place personnel with appropriate skills to vet models used by the front office and to price the instruments used, and that pricing follows market convention. These functions should also be separate from the front office.

- h. The supervisory authority requires that the board of directors ensure that the insurer has the appropriate capability to verify pricing independently where the use of 'over-the-counter' derivatives is permitted under the insurer's policy.
- i. The supervisory authority requires that insurers have in place rigorous audit procedures that include coverage of their derivatives activities to ensure the timely identification of internal control weaknesses and operating system deficiencies. If the audit is performed internally it should be independent of the function being reviewed.

**ICP 23 Capital adequacy and solvency**

The supervisory authority requires insurers to comply with the prescribed solvency regime. This regime includes capital adequacy requirements and requires suitable forms of capital that enable the insurer to absorb significant unforeseen losses.

**Explanatory note**

23.1. A sound solvency regime is essential to the supervision of insurance companies and the protection of policyholders. Capital adequacy requirements are part of a solvency regime. A solvency regime should take into account not only the sufficiency of technical provisions to cover all expected and some unexpected claims and expenses but also the sufficiency of capital to absorb significant unexpected losses - to the extent not covered by the technical provisions - on the risks for which capital is explicitly required. It should also require additional capital to absorb losses from risks not explicitly identified.

23.2. In order to protect policyholders from undue loss, it is necessary that a solvency regime establishes not only minimum capital adequacy requirements, but also a solvency control level, or series of control levels, which act as indicators or triggers for early supervisory action, before problems become serious threats to an insurer's solvency. The form of the solvency control level may be based on capital levels or other financial measures related to the solvency regime of the jurisdiction.

23.3. Any allowance for reinsurance in a capital adequacy and solvency regime should consider the effectiveness of the risk transfer and make allowance for the likely security of the reinsurance counterparty.

***Essential criteria***

- a. The solvency regime addresses in a consistent manner:
  - valuation of liabilities, including technical provisions and the margins contained therein
  - quality, liquidity and valuation of assets
  - matching of assets and liabilities
  - suitable forms of capital
  - capital adequacy requirements.
- b. Any allowance for risk mitigation or transfer considers both its effectiveness and the security of any counterparty.
- c. Suitable forms of capital are defined.
- d. Capital adequacy requirements are sensitive to the size, complexity and risks of an insurer's operations, as well as the accounting requirements that apply to the insurer.

- e. The minimum capital adequacy requirements should be set at a sufficiently prudent level to give reasonable assurance that policyholder interests will be protected.
- f. Capital adequacy requirements are established at a level such that an insurer having assets equal to the total of liabilities and required capital will be able to absorb significant unforeseen losses.
- g. Solvency control levels are established. Where the solvency position reaches or falls below one or more control levels, the supervisory authority intervenes and requires corrective action by the insurer or imposes restrictions on the insurer. The control level is set so that corrective action can be taken in a timely manner (refer to ICP 14).
- h. Inflation of capital – through double or multiple gearing, intra-group transactions, or other financing techniques available as a result of the insurer’s membership in a corporate group – is addressed in the capital adequacy and solvency calculation (refer to ICP 17).
- i. The solvency regime addresses the requirements placed upon an insurer operating through a branch.

***Advanced criteria***

- j. The solvency regime provides for periodic, forward-looking analysis (e.g., dynamic solvency/stress testing) of an insurer’s ability to meet its obligations under various conditions (refer to ICP 20 AC g and ICP 21 AC k).
- k. The supervisory authority assesses the structure of its solvency regime against structures of a peer group of jurisdictions and works towards achieving consistency.

## **7. Markets and consumers**

16. The following principles address issues of market conduct that are an essential area of the supervision in the insurance sector, and may have a reputation risk or prudential impact on insurers.

|               |                       |
|---------------|-----------------------|
| <b>ICP 24</b> | <b>Intermediaries</b> |
|---------------|-----------------------|

|  |
|--|
| The supervisory authority sets requirements, directly or through the supervision of insurers, for the conduct of intermediaries. |
|--|

**Explanatory note**

24.1. In many insurance markets, intermediaries serve as important distribution channels of insurance. They provide the interface between consumers and the insurer. Their good conduct is essential to protect consumers and promote confidence in insurance markets. For this reason, intermediaries should be directly or indirectly supervised. Where intermediaries are supervised directly, then the supervisory authority should be able to conduct on-site inspection when needed (refer to ICP 13 EC f).

24.2. Intermediaries include all those who are engaged in insurance intermediation activities.

***Essential criteria***

- a. The supervisory authority requires intermediaries to be licensed or registered.



- b. The supervisory authority requires intermediaries to have adequate general, commercial and professional knowledge and ability as well as having a good reputation.
- c. If necessary, the supervisory authority takes corrective action, including applying sanctions, directly or through insurers, and cancelling the intermediary's licence or registration, when appropriate.
- d. The supervisory authority requires an intermediary who handles client's money to have sufficient safeguards in place to protect these funds.
- e. The supervisory authority requires intermediaries to give customers information on their status, specifically whether they are independent or associated with particular insurance companies and whether they are authorised to conclude insurance contracts on behalf of an insurer or not.
- f. The supervisory authority or other authority must have powers to take action against those individuals or entities that are carrying on insurance intermediation activity without license or registration.

**ICP 25 Consumer protection**

The supervisory authority sets minimum requirements for insurers and intermediaries in dealing with consumers in its jurisdiction, including foreign insurers selling products on a cross-border basis. The requirements include provision of timely, complete and relevant information to consumers both before a contract is entered into through to the point at which all obligations under a contract have been satisfied.

**Explanatory note:**

25.1. Requirements for the conduct of insurance business help to strengthen consumer confidence in the insurance market.

25.2. The supervisory authority requires insurers and intermediaries to treat their customers fairly, paying attention to their information needs. With respect to consumers in their own jurisdiction, the supervisory authority should set requirements with which insurers and intermediaries must comply. The requirements applicable to cross-border sales should also be clear.

25.3. A good claim resolution process is essential for the fair treatment of consumers. For this purpose, some jurisdictions have established extra judicial claim resolution mechanisms, such as independent panels or arbitrators.

25.4. For a large number of consumers, insurance products are difficult to understand and evaluate. Insurers and intermediaries have a greater knowledge of insurance issues than the consumers. Arrangements should therefore exist for potential policyholders:

- to have access to information needed to make an informed decision before entering into a contract
- to be informed about their rights and obligations for the duration of the contract

25.5. These requirements should distinguish between particular types of customers. In particular, detailed conduct of business rules may not be appropriate for reinsurance transactions or in respect of professional customers. Nonetheless this does not relieve reinsurers of their duty to provide complete and accurate information to the insurers with whom they deal

### ***Essential criteria***

- a. The supervisory authority requires insurers and intermediaries to act with due skill, care and diligence in their dealing with consumers.
- b. The supervisory authority requires insurers and intermediaries to have policies on how to treat consumers fairly and to have systems and provide training to ensure compliance with those policies by their employees and other sales collaborators.
- c. The supervisory authority requires insurers and intermediaries to seek the information from their consumers that is appropriate in order to assess their insurance needs, before giving advice or concluding a contract.
- d. The supervisory authority sets requirements for insurers and intermediaries with regard to the content and timing of provision of information:
  - on the product, including the associated risks, benefits, obligations, and charges
  - on other matters related to the sale, including possible conflict of interest to existing or potential policyholders.
- e. The supervisory authority requires insurers and intermediaries to deal with claims and complaints effectively and fairly through a simple, easily accessible and equitable process.

### ***Advanced criteria***

- f. The supervisory authority requires insurers and intermediaries to set rules on the handling of customer information paying due regard to the protection of private information of customers.
- g. The supervisory authority gives information to the public about whether and how local legislation applies to the cross-border offering of insurance, such as e-commerce. The supervisor issues warning notices to consumers when necessary in order to avoid transactions with unsupervised entities.
- h. The supervisory authority promotes the consumers' understanding of the insurance contracts.

|               |  |
|---------------|--|
| <b>ICP 26</b> | <b>Information, disclosure &amp; transparency towards the market</b> |
|---------------|--|

|  |
|--|
| <p>The supervisory authority requires insurers to disclose relevant information on a timely basis in order to give stakeholders a clear view of their business activities and financial position and to facilitate the understanding of the risks to which they are exposed.</p> |
|--|

### **Explanatory note**

26.1. Public disclosure of reliable and timely information facilitates the understanding by prospective and existing stakeholders of the financial position of insurers and the risks to which they are subject, regardless of whether they are publicly traded or not.

26.2. Supervisory authorities are concerned with maintaining efficient, fair, safe and stable insurance markets for the benefit and protection of policyholders. When provided with appropriate information markets can act efficiently, rewarding those insurers that operate effectively and penalising those that do not. This aspect of market discipline serves as an adjunct to supervision.

26.3. Regular disclosure can facilitate the smooth functioning of the insurance markets. For example, when timely public disclosure exists market participants are less likely to overreact to negative information about an insurer.

26.4. Greater disclosure entails increased costs, which may be direct or indirect. For example, companies may experience a competitive disadvantage from increased disclosure of proprietary information. These costs must be weighed against the potential benefit of increased disclosure required by any standards.

26.5. The supervisory authority takes action, if necessary in coordination with other relevant bodies, to ensure effective and relevant disclosure.

#### ***Essential criteria***

- a. Insurers are required to disclose information on their financial position and the risks to which they are subject. Specifically, information disclosed should be:
  - relevant to decisions taken by market participants
  - timely so as to be available and up-to-date at the time those decisions are made
  - accessible without undue expense or delay by the market participants
  - comprehensive and meaningful so as to enable market participants to form a well-rounded view of the insurer
  - reliable as a basis upon which to make decisions
  - comparable between different insurers
  - consistent over time so as to enable relevant trends to be discerned.
- b. Information includes quantitative and qualitative information on:
  - financial position
  - financial performanceand a description of:
  - the basis, methods and assumptions upon which information is prepared (and comments on the impact of any changes)
  - risks exposures and how they are managed
  - management and corporate governance.
- c. Insurers are required to produce, at least annually, audited financial statements and make them available to stakeholders.
- d. The supervisory authority monitors the information disclosed by insurers and takes the necessary actions to ensure the compliance with disclosure requirements.

#### ***Advanced criteria***

- e. Information includes quantitative information of relevant risk exposures.

|               |              |
|---------------|--------------|
| <b>ICP 27</b> | <b>Fraud</b> |
|---------------|--------------|

|   |
|---|
| <p>The supervisory authority requires that insurers and intermediaries take the necessary measures to prevent, detect and remedy insurance fraud.</p> |
|---|

## **Explanatory note**

27.1. The supervisory authority has an important role to play in combating fraud in insurance in its jurisdiction. It communicates with other supervisors in addressing such fraud across jurisdictions.

27.2. Fraud can be perpetrated by any party involved in insurance, e.g. insurers, insurers' managers and staff, intermediaries, accountants, auditors, consultants, claims adjusters as well as policyholders.

27.3. Most jurisdictions have legal provisions against fraud in insurance. In many jurisdictions, instances of fraud are criminal acts.

27.4. Fraud in insurance results in reputational as well as financial damage and social and economic costs. That is why the supervisory authority requires that insurers and intermediaries address it effectively.

### ***Essential criteria***

- a. The supervisory authority has the powers and resources to establish and enforce regulations and to communicate as appropriate with enforcement authorities, as well as with other supervisors, to deter, detect, record, report and remedy fraud in insurance.
- b. Legislation addresses insurer fraud.
- c. Claims fraud is a punishable offence.
- d. The supervisory authority requires insurers and intermediaries to ensure high standards of integrity of their business.
- e. The supervisory authority requires that insurers and intermediaries allocate appropriate resources and implement effective procedures and controls to deter, detect, record and, as required, promptly report fraud to appropriate authorities. This function is under the responsibility of senior staff of the insurer and intermediary.
- f. As required, the supervisory authority ascertains that insurers take effective measures to prevent fraud, including providing counter-fraud training to management and staff. The supervisory authority promotes the exchange of information between insurers with respect to fraud and those committing fraud including, as appropriate, through the use of databases.
- g. The supervisory authority co-operates with other supervisory authorities including, as appropriate, in other jurisdictions in countering fraud.

## 8. Anti-money laundering, combating the financing of terrorism

### ICP 28 Anti-money laundering, combating the financing of terrorism (AML/CFT)

The supervisory authority requires insurers and intermediaries, at a minimum those insurers and intermediaries offering life insurance products or other investment related insurance, to take effective measures to deter, detect and report money laundering and the financing of terrorism consistent with the Recommendations of the Financial Action Task Force on Money Laundering (FATF).

#### Explanatory note

28.1. In most IAIS member jurisdictions, money laundering and financing of terrorism are criminal acts under the law. Money laundering is the processing of criminal proceeds to disguise their illegal origin. The financing of terrorism involves the direct or indirect provision of funds, whether lawfully or unlawfully obtained, for terrorist acts or to terrorist organisations.

28.2. Insurers and intermediaries, in particular those insurers and intermediaries offering life insurance or other investment related insurance could be involved, knowingly or unknowingly, in money laundering and financing of terrorism. This exposes them to legal, operational and reputational risks. Supervisory authorities, in conjunction with law enforcement authorities and in co-operation with other supervisors, must adequately supervise insurers and intermediaries for AML/CFT purposes to prevent and counter such activities.

#### *Essential criteria*

- a. The measures required under the AML/CFT legislation and the activities of the supervisors should meet the criteria under those FATF Recommendations applicable to the insurance sector.<sup>5</sup>
- b. The supervisory authority has adequate powers of supervision, enforcement and sanction in order to monitor and ensure compliance with AML/CFT requirements. Furthermore, the supervisory authority has the authority to take the necessary supervisory measures to prevent criminals or their associates from holding or being the beneficial owner of a significant or controlling interest or holding a management function in an insurer or an intermediary.
- c. The supervisory authority has appropriate authority to co-operate effectively with the domestic Financial Intelligence Unit (FIU) and domestic enforcement authorities, as well as with other supervisors both domestic and foreign, for AML/CFT purposes.
- d. The supervisory authority devotes adequate resources - financial, human and technical - to AML/CFT supervisory activities.
- e. The supervisory authority requires insurers and intermediaries, at a minimum those insurers and intermediaries offering life insurance products or other investment related insurance, to comply with AML/CFT requirements, which are consistent with the FATF Recommendations applicable to the insurance sector, including:

---

<sup>5</sup> See FATF Recommendations 4-6, 8-11, 13-15,17,21-23, 25, 29-32 and 40 as well as Special Recommendations IV, V and the AML /CFT Methodology for a description of the complete set of AML/CFT measures that are required.

- performing the necessary customer due diligence (CDD) on customers, beneficial owners and beneficiaries
- taking enhanced measures with respect to higher risk customers
- maintaining full business and transaction records, including CDD data, for at least 5 years
- monitoring for complex, unusual large transactions, or unusual patterns of transactions, that have no apparent or visible economic or lawful purpose
- reporting suspicious transactions to the FIU
- developing internal programmes (including training), procedures, controls and audit functions to combat money laundering and terrorist financing
- ensuring that their foreign branches and subsidiaries observe appropriate AML/CFT measures consistent with the home jurisdiction requirements.

## Annex 1 - References<sup>6</sup>

### Conditions for effective supervision

|       |  |
|-------|--|
| ICP 1 | Conditions for effective insurance supervision |
|-------|--|

#### The supervisory system

|       |   |
|-------|---|
| ICP 2 | Supervisory objectives                          |
| ICP 3 | Supervisory authority                           |
| ICP 4 | Supervisory process                             |
| ICP 5 | Supervisory cooperation and information sharing |

#### References:

- Principles No. 2. Principles Applicable to the Supervision of International Insurers and Insurance Groups and their Cross-Border Business Operations (*Approved December 1999*)
- Principles No. 6. Principles on Minimum Requirements for Supervision of Reinsurers (*Approved October 2002*)
- Supervisory Standard No. 6. Supervisory Standard on the Exchange of Information (*Approved January 2002*)
- Supervisory Standard No. 8. Standard on supervision of reinsurers (*Approved October 2003*)
- Guidance Paper No. 2. A Model Memorandum of Understanding (to facilitate the exchange of information between financial supervisors) (*Approved September 1997*)
- IMF's Code of Good Practices on Transparency in Monetary and Financial Policies: Declaration of Principles (*September 1999 and July 2000*)

#### The supervised entity

|        |  |
|--------|--|
| ICP 6  | Licensing                                  |
| ICP 7  | Suitability of persons                     |
| ICP 8  | Changes in control and portfolio transfers |
| ICP 9  | Corporate governance                       |
| ICP 10 | Internal control                           |

#### References:

- Principles No. 2. Principles Applicable to the Supervision of International Insurers and Insurance Groups and their Cross-Border Business Operations (*Approved December 1999*)
- Principles No. 6. Principles on Minimum Requirements for Supervision of Reinsurers (*Approved October 2002*)
- Supervisory Standard No. 1. Supervisory Standard on Licensing (*Approved October 1998*)
- Supervisory Standard No.3. Supervisory Standard on Derivatives (*Approved October 1998*)
- Supervisory Standard No.4. Supervisory Standard on Asset Management by Insurance Companies (*Approved December 1999*)
- Supervisory Standard No.7. Supervisory Standard on the Evaluation of the Reinsurance Cover (*Approved January 2002*)
- Supervisory Standard No. 8. Standard on supervision of reinsurers (*Approved October 2003*)
- Guidance Paper No 1. Guidance on Insurance Regulation and Supervision for Emerging Market Economies (*Approved September 1997*)

---

<sup>6</sup> Note: papers that are still in draft but whose adoption is anticipated at the October 2003 General Meeting are listed in bold. Annual updating of this part of the document will be necessary.

- Guidance Paper No. 2. A Model Memorandum of Understanding (to facilitate the exchange of information between financial supervisors) (*Approved September 1997*)
- Guidance Paper No. 3. Guidance Paper for Fit And Proper Principles and their Application (*Approved October 2000*)
- Guidance Paper No. 7: The Use of actuaries as part of a supervisory model (*Approved October 2003*)

### **On-going Supervision**

|        |  |
|--------|--|
| ICP 11 | Market analysis                                  |
| ICP 12 | Reporting to supervisors and off-site monitoring |
| ICP 13 | On-site inspection                               |
| ICP 14 | Preventive and corrective measures               |
| ICP 15 | Enforcement or sanctions                         |
| ICP 16 | Winding-up & exit from the market                |
| ICP 17 | Group-wide supervision                           |

#### References:

- Principles No. 6. Principles on Minimum Requirements for Supervision of Reinsurers (*Approved October 2002*)
- Supervisory Standard No. 2. Supervisory Standard on On-Site Inspections (*Approved October 1998*)
- Supervisory Standard No. 5. Supervisory Standard on Group Coordination (*Approved October 2000*)
- Supervisory Standard No. 7. Supervisory Standard on the Evaluation of the Reinsurance Cover (*Approved January 2002*)
- Guidance Paper No. 6: Solvency control levels (*Approved October 2003*)
- Joint Forum papers pertaining to:
  - coordination
  - supervisory information sharing
  - capital adequacy
  - fit and proper tests
  - intra-group transactions and exposures
  - risk concentrations

### **Prudential requirements**

|        |                                     |
|--------|-------------------------------------|
| ICP 18 | Risk assessment and management      |
| ICP 19 | Insurance activity                  |
| ICP 20 | Liabilities                         |
| ICP 21 | Investments                         |
| ICP 22 | Derivatives and similar commitments |
| ICP 23 | Capital adequacy and solvency       |

#### References:

- Principles No. 5. Principles on Capital Adequacy and Solvency (*Approved January 2002*)
- Principles No. 6. Principles on Minimum Requirements for Supervision of Reinsurers (*Approved October 2002*)
- Supervisory Standard No. 3. Supervisory Standard on Derivatives (*Approved October 1998*)
- Supervisory Standard No. 4. Supervisory Standard on Asset Management by Insurance Companies (*Approved December 1999*)



- Supervisory Standard No. 7. Supervisory Standard on the Evaluation of the Reinsurance Cover (*Approved January 2002*)
- Supervisory Standard No. 8. Standard on supervision of reinsurers (*Approved October 2003*)
- Guidance Paper No. 7: The Use of actuaries as part of a supervisory model (*Approved October 2003*)
- Guidance Paper No. 6: Solvency control levels (*Approved October 2003*)
- Guidance Paper No. 8: Stress testing (*Approved October 2003*)
- Discussion Paper Quantifying and Assessing Insurance Liabilities - January 2003

### **Markets and consumers**

|        |   |
|--------|---|
| ICP 24 | Intermediaries  |
| ICP 25 | Consumer protection                                       |
| ICP 26 | Information, disclosure & transparency towards the market |
| ICP 27 | Fraud   |

#### References:

- Principles No. 3. Principles for the Conduct of Insurance Business (*Approved December 1999*)
- Principles No. 4. Principles on the Supervision of Insurance Activities on the Internet (*Approved October 2000*)
- Guidance Paper No. 4. Guidance Paper on Public Disclosure by Insurers (*Approved January 2002*)

### **Anti-money laundering/ Combating the Financing of Terrorism**

|        |   |
|--------|---|
| ICP 28 | Anti-money laundering/ Combating the Financing of Terrorism |
|--------|---|

#### References:

- Guidance Paper No. 5. Anti-Money Laundering Guidance Notes for Insurance Supervisors and Insurance Entities (*Approved January 2002*)
- Methodology for Assessing Compliance with Anti-Money Laundering and Combating the Financing of Terrorism Standards (*prepared IMF, World Bank, Financial Action Task Force and approved by at an FATF plenary meeting October 2002*)

## **Annex 2 - Assessment methodology**

1. This annex sets out factors that should be considered when carrying out an assessment of a jurisdiction or authority's observance of the *Insurance core principles* and criteria.
2. The IAIS strongly encourages implementation of the framework for effective supervision described by the *Insurance core principles*. Assessments can facilitate implementation by identifying the extent and nature of any weaknesses in a jurisdiction's supervisory framework -- especially those aspects that could affect policyholder protection and market stability -- as well as recommending possible remedies.
3. The framework described by the *Insurance core principles* is general. Supervisors have flexibility in adapting it to the domestic context (e.g., depending on the market structure and stage of development). The explanatory notes and criteria provide more guidance on what is expected in order to implement each principle. They also facilitate assessments that are comprehensive, precise and consistent. While the results of the assessments may not always be made public, it is still important for their credibility that they are conducted in a broadly uniform manner from jurisdiction to jurisdiction.

### **Scope**

4. Assessments against the *Insurance core principles* can be conducted in a number of contexts including:
  - self assessments performed by insurance supervisors themselves, sometimes with the assistance of other experts
  - reviews conducted by third parties and, in particular, those conducted in the context of the IMF and World Bank Financial Sector Assessment Program (FSAP).
5. Assessments can be limited to the responsibilities of a particular insurance supervisory authority or relate to the jurisdiction as a whole. Whatever the case, this should be clearly understood by all parties concerned. FSAP reviews are always done with respect to the jurisdiction as a whole. Where more than one authority is involved in the supervisory process then the interaction of supervisory roles should be clearly described in the assessment.

### ***Conduct of independent assessments - assessment by experts***

6. The process of assessing each principle requires a judgmental weighing of numerous elements that only qualified assessors with practical and relevant experience can provide. Normally an independent assessment would be conducted by at least one expert. Assessors not familiar with the insurance sector, while possibly providing a fresh perspective, could come to incorrect or misleading conclusions due to their lack of sector specific knowledge.

### ***Conduct of independent assessments - access to information***

7. When conducting an independent assessment, prior consent from the relevant local authorities is required so that assessors can have access to a range of information and people. The required information may include not only published information such as the laws, regulations and administrative policies but also non-published information, such as self-assessments, operational guidelines for insurance supervisors, and the like. The information should be provided as long as it does not violate confidentiality requirements. The assessor will need to meet with various individuals and organisations, including the insurance supervisor or supervisors, other domestic supervisory authorities, any relevant government ministries, insurance companies and insurance industry associations, actuaries, auditors, and other financial sector participants.

## Assessment categories

### *Assessment of essential criteria*

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

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

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

11. Assessments are based solely on the laws, regulations and other supervisory requirements or practices that are in place at the time. Proposed improvements can be noted in the assessment report by way of additional comments so as to give credit for efforts that are important but at the time the assessment is made, have yet to be fully implemented. Similarly, laws that do not meet with a satisfactory level of observance in practice cannot be recorded as “observed”. As a result, it is important to recognise when the assessment is conducted and to record this in the report.

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

13. A criterion would be considered **not applicable** whenever:

- the criterion does not apply given the structural, legal and institutional features of a jurisdiction<sup>7</sup>
- an assessment is conducted in the context of the individual supervisory authority and the criterion is the responsibility of other authorities in the jurisdiction (for example for ICP 1). In this instance, the relevant authority should be clearly identified in the assessment report.

14. In the assessment of ICP 1 the assessor may refer to recent assessments or studies on these matters by public international institutions where available.

---

<sup>7</sup>. An example of this situation is if a jurisdiction prohibits the use of derivatives and similar commitments. In such a case, most, if not all, of the criteria under ICP 22 would be noted as not applicable.

### *Assessment of advanced criteria*

15. With respect to the advanced criteria set forth in this document, these may or may not be assessed depending on the objectives and views of those sponsoring the exercise. Even when they are included, however, the results will not be a factor in coming to an overall view on observance with a principle. Instead, the assessment of the advanced criteria is recorded in the description and informs the comments and recommendations as appropriate. For consistency only essential criteria are taken into account in the assessment of the overall core principle.

### *Assessment of principles*

16. As noted above, the level of observance for each principle reflects the assessments of the essential criteria. A principle will be considered **observed** whenever all the essential criteria are considered to be observed or when all the essential criteria are observed except for a number that are considered not applicable. A principle will be considered to be **not applicable** when the essential criteria are considered to be not applicable.

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

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

### **Reporting**

19. The IAIS does not prescribe the precise format or content of reports that result from an assessment against the *Insurance core principles*. It does, however, consider that the report should:

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

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