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INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS

PRINCIPLES ON GROUP-WIDE SUPERVISION

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Principles on group-wide supervision

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1. Scope and Definitions

1.1 Scope

1. The groups that are covered by these Principles are those whose main activity is insurance. While the concept of group does not exclude financial conglomerates, in applying these Principles to a financial conglomerate, they should be applied only in respect of its insurance activities (e.g. insurance subgroups in the case of a financial conglomerate with a bank parent company), and may not be applicable to the broader issues that may arise from the specific nature and characteristics of the conglomerate.

2. These Principles are designed to establish an internationally acceptable framework that contributes to ensuring appropriate streamlining, consistency, efficiency and effectiveness of supervision on a group-wide basis; they are not intended to establish a detailed supervisory regime or best practices applying to groups.

3. The Principles focus, initially, on the aims of group-wide supervision and then on the means to achieve these aims (e.g. the responsibilities of different supervisors, mechanisms of cooperation and exchange of information).

4. In developing these Principles, regard has been given to the work of the Joint Forum and other relevant organisations, with the aim of achieving appropriate consistency.

5. **It is not the intention, through the establishment of these Principles, to lessen the importance of solo supervision or to replace the role of the solo supervisor**.

1.2 Definitions

- **Insurer (also insurance company):** A licensed legal entity which underwrites (direct) insurance or reinsurance.
- **Subsidiary:** A legal entity that is controlled by another entity.
- **Financial conglomerate:** Any group of companies under common control whose exclusive or predominant activities consist of providing significant services in at least two different financial sectors (banking, securities, insurance).
- **Solo supervision:** The supervision of a licensed financial entity, by the supervisor in the jurisdiction where the licensed financial entity is incorporated, whereby the supervised entity is treated as a “stand-alone” entity. The solvency requirements are applied on a stand-alone basis. However, this does not preclude consideration by the supervisor of group aspects.
- **Group-wide supervision:** A supervisory approach to a financial group which considers the group structure, the constituent licensed entities and all the interrelationships within that financial group.
- **Follow-up approach:** In the context of the supervision of a regulated insurance entity, a supervisor may require information through that regulated entity on non-regulated entities.

2. Introduction

2.1 The need for group-wide supervision

6. The financial position and the risk profile of an insurer may be affected by its belonging to a group, with the possibility of both positive and negative effects on its prudential situation. Some examples include[1]:

- On the one hand, an insurer may have access to better sources of finance, including financial support from its parents and siblings in circumstances of need, as well as greater access to technical resources, skills, expertise and enhanced risk management capability due to the operation of group risk management and control functions. Moreover, both the group and the insurer may also benefit from geographical and other diversification effects[2].

- On the other hand, an insurer may be exposed to financial weakness in other group entities through financial and operational risk. An insurer may grant loans to, own shares of, or provide insurance to other entities within the group. A group may decide to absorb losses made by an entity within the group beyond the group’s legal commitments, to preserve the integrity of brand or to avoid the reputational impacts of winding-up a part of the group. The influence of the policy of the group may result in the insurer bearing risks beyond those it would bear on a stand-alone basis. Moreover, a situation may arise within the group where the same capital is used more than once for solvency purposes. It is important to recognise that such double gearing could occur both within a jurisdiction and across jurisdictions and between regulated and non-regulated entities.

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1 This is not intended as a comprehensive list of the pros and cons of belonging to a group, but rather some illustrative examples of positive and negative effects which may arise.

2 The extent of any recognition of diversification effects in the assessment of capital adequacy on a group-wide basis is still being considered within the IAIS.

7. It is, therefore, important for supervisors of insurers within a group to be able to form a comprehensive view of the overall group business strategy, financial position, legal and regulatory position, and the risk exposure of the group as a whole, which will enable supervisors to assess (and react to, as necessary) the prudential situation and solvency of the respective insurers within the group.

8. Significant management and policy decisions are often taken at, or triggered by, the head of the group, so it is important to consider the management structure of the group in assessing the soundness of the insurers within the group. Assessment of the quality of risk management and internal controls on a group-wide basis is also important to assess whether the decisions made by the management at the head of the group are based on a full understanding of risks occurring in each insurer as well as across the group as a whole.

9. While these issues are reflected in the IAIS Insurance Core Principle on Group-wide supervision (ICP 17) [see Annex 1], the *Report on the ICP Self-Assessment Exercise 2004/05* (February 2006), identified that group-wide supervision is one of the least developed and observed of the IAIS core principles. Some supervisory regimes are exclusively rooted in a basis of solo supervision and, overall, group-wide supervision is an area where supervisory practice is still developing.

10. Accordingly, these Principles provide an elaboration on the requirements of ICP17, to further promote and facilitate efficient and effective group-wide supervision.

2.2 The need for streamlining group-wide supervision

11. Most internationally active insurers are organised in the form of groups with insurers within the group incorporated according to the legal framework of their respective local jurisdiction.

12. The assessment of the overall solvency of a group is an important issue for the international supervisory community. According to ICP 17, “the supervisory authority supervises its insurers on a solo and a group-wide basis”. One way to achieve this and to meet the requirements of ICP 17 is to give additional powers to the supervisor in the jurisdiction where the head of the group is based to enable it to supervise on a group-wide basis and to assess the overall solvency of the group. Another way is for the supervisor to maintain supervisory powers only on the solo entity, yet have powers to require needed information from the group (through a group-wide supervisor) to assess the group’s impact on the solo entity, mitigating where appropriate, unnecessary overlaps or additional administrative burdens.

13. Some jurisdictions may also have supervisory requirements that apply to the group as a whole, or at least to the local subgroups, even though the group is not based in that jurisdiction. In such cases, the supervised entities will benefit from intensive cooperation among the relevant supervisors based on efficient administrative procedures and exchange of information so as to avoid unnecessary duplication or contradictory supervision of insurers.

14. Even though the essential criteria of ICP 17 require that “supervisory authorities cooperate to avoid unnecessary duplication”, it is possible that, without further guidance, the implementation of ICP 17 in each jurisdiction may lead to some overlaps of, or deficiencies in, the supervisory efforts in respect of a given group. Supervisors need clearly defined responsibilities in respect of solo and group-wide supervision. They should also be able to enter into agreements in relation to supervision on a group-wide basis, including on procedures for coordination of group-wide supervision.

15. These Principles, in supporting the detailed implementation of ICP 17, seek to facilitate appropriately streamlined, consistent, efficient and effective group-wide supervision - supporting a supervisory framework that avoids unnecessary overlaps and material deficiencies, and unnecessary supervisory burden for the industry.

16. This will be achieved while:

- preserving the standards of protection of policyholders
- ensuring the soundness of each insurer and maintaining financial stability, and
- taking into account economic reality.

3. Principles on group-wide supervision

Principle 1: Capital adequacy should be assessed on a group-wide basis.

Principle 2: The fitness and propriety of the board and senior management of the group, as well as the propriety of significant shareholders, should be assessed on a group-wide basis.

Principle 3: Adequate risk management and internal controls should be in place within the group and should be assessed on a group-wide basis to enhance the assessment of the solo entities.

Principle 4: Supervisors should have the skills and the appropriate authority to carry out supervision on a group-wide basis.

Principle 5: Necessary provisions and arrangements should be in place to allow efficient and effective supervision through cooperation and exchange of information among supervisors of the group.

4. Explanatory notes to the Principles on group-wide supervision

NB: These explanatory notes do not aim at setting new detailed requirements, but at clarifying, explaining and illustrating the Principles.

4.1 Capital adequacy

Principle 1: Capital adequacy should be assessed on a group-wide basis.

17. In the assessment of capital adequacy on a group-wide basis, there are accounting/measurement issues that need to be addressed. The situation where an insurance company owns shares in another insurance company is fairly common. Creation of capital may occur, for example, where a parent issues debt and downstreams the funds to

create equity in a subsidiary. In addition, less transparent or inappropriate means[3] may be used to develop double gearing and internal creation of capital. This can be performed through different channels using regulated or non-regulated entities. The assessment of capital adequacy on a group-wide basis should adjust for forms of intra-group transactions, including internal participation structures and intra-group transfers of capital and risks.

18. For the separate assessment of capital adequacy on a group-wide basis, a benchmark has to be established against which that assessment is undertaken. That is, mechanisms exist to ensure capital is adequate at the group level. It is acknowledged that in some jurisdictions, capital is calculated on a solo entity basis only, with no separate group-wide capital requirement. However, in undertaking that solo assessment due consideration is given to group impacts, including assessment of any insurance holding companies.

19. The complexity of the task of assessing capital on a group-wide basis is largely dependent on the complexity of the structure of the group itself. Some structural features or techniques which may raise specific concerns include partially owned entities, cross-sectoral participations, a continuous sequence of internal financing within the group, or closed loops in the financing scheme of the group.

20. To assess capital adequacy on a group-wide basis, three main approaches can be taken:

- Aggregation methods: No capital requirement is calculated at group level on a consolidated basis. Excess or deficits of capital existing at the level of each entity in the group, i.e. on a solo basis, are aggregated (with relevant adjustments being made for internal holding) in order to measure surplus (or deficit) at group level. Special care should be taken in the modeling of internal transactions in order to make sure that the value and the risk of such instruments are consistently treated across the whole group.

- Consolidated methods: aim to calculate a capital requirement at group level treating the group as a single entity, and determine whether this requirement is sufficiently covered by capital elements at the group level. This category includes all methods of calculation that use group consolidated accounts. This method will include all regulated entities in the group and any intermediate holding companies. This method however has limitations in stress situations to the extent the group does not behave or is not allowed to behave as one legal entity[4].

- Legal entity method: Calculate capital for the parent company only as a solo entity, with no separate group capital requirements. However, group impact (at least risks and perhaps benefits) are measured within the capital requirements. Additional group impact not measured within the capital requirements is assessed in qualitative analyses. This method includes evaluation of accounting/measurement issues and the economic and financial impact of any linked company explicit and implicit relationships on the solo entity. This method also requires special attention to the need to avoid unnecessary overlap and additional administrative burden through

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3 For instance ordinary loans may be granted to a non-regulated subsidiary which will downstream the proceeds in the form of equities in insurance subsidiaries or other regulated financial entities within the group.

4 To address this problem, methods have been developed which focus on the structure of the group: the effects of intra-group transactions are analysed and assessed by soundly modelling the capital flows between entities within the group, under adverse conditions, and assessing the resulting financial risks and impacts on required capital of each entity and in particular the parent company.

appropriate communication and coordination among supervisors.

21. The choice of which method is appropriate would depend on the preconditions in a jurisdiction, the legal environment, which assigns on what level the capital requirement is assessed, and the structure of the group.

4.2 Governance and risk management

Principle 2: The fitness and propriety of the board and senior management of the group, as well as the propriety of significant shareholders, should be assessed on a group-wide basis.

22. Given that key strategic decisions are often taken at, or influenced by, the head of the group, it is not sufficient to assess only the fitness and propriety of the board and senior management of the individual insurers within the group. It is also necessary that supervisors assess the fitness and propriety of the board and the senior management of the group. For effective group-wide supervision, the supervisor should assess that at the group level all persons who effectively run the insurer or have other key functions are fit and proper.

23. It is also necessary that supervisors check the propriety of significant owners at the group level (that is, the board of entities or natural persons which have a significant shareholding in, or a significant influence over, the activities of the head of the group) to ensure that the sound and prudent management of the insurer is not endangered. The assessment of the propriety of significant owners would entail:

- assessing the shareholders' appropriate financial strength;
- checking that the shareholder does not have a negative influence on the corporate governance or the objectives of the insurer(s) (including their achievement); and
- investigating the shareholders' integrity and reliability.

24. The supervisor of the jurisdiction where the head of the group is based (the group-wide supervisor) takes the appropriate lead in these responsibilities of group-wide supervision, unless there is agreement between supervisors of an alternative group-wide supervisor. A group-wide supervisor should take into account the assessment made by the solo supervisors as far as relevant.

25. To be able to fulfil this duty, the relevant supervisor should have adequate authority and appropriate power (refer to Principle 4). In particular, where the head of the group is not itself a regulated entity (for instance, where it is a pure holding company), the group-wide supervisor should have appropriate power and authority to assess and ensure the compliance with corporate governance requirements at the head of the group. This requirement, however, should not be taken to imply that non-regulated holding companies should be treated as fully regulated entities.

26. This aim could be reached either by direct means where the supervisor has explicit authority and power over the head of the group, or through the use of a follow-up approach where the supervisor has adequate power and authority over the regulated insurer to access information in respect of the head of the group.

Principle 3: Adequate risk management and internal controls should be in place within the group and should be assessed on a group-wide basis to enhance the assessment of the solo entities.

27. Groups may adopt different types of management structure: in some groups the management structure may correspond closely to the legal entity structure, whereas in others this is not the case. Supervisors should take the management structure of the group into consideration and assess whether risk is being adequately managed at the appropriate level within the group.

28. When business activities and risks are managed independently of legal entities, e.g. on a business-line basis across the group, it is not sufficient to assess risk management only at individual insurer level. Supervisors need to be able to establish, with a reasonable level of assurance, that risks are being managed appropriately on a group-wide basis and that the soundness of both the group and each insurer within the group is secured.

29. Even in the case where insurers within the group are independently managed, their respective decisions and risk management policies may have consequences for the group as a whole and the other entities within the group. Appropriate assessment of risk management and internal controls on a group-wide basis is still important.

30. Being part of a group may enable some insurers to underwrite larger amounts of risk, and risks of higher magnitude, than would be possible on a stand-alone basis. Risk mitigation arrangements (e.g. reinsurance) may or may not be in place. It is, therefore, crucial that the role of each insurer within the group is clearly defined and that clear limits on the risk taken by the insurers are established. It is also crucial that the group as a whole has robust internal control mechanisms in place to identify risks, of legal entities or on a business-line basis as appropriate, across the group, and to enable the senior management at the head of the group to have relevant and timely information for its decision making processes.

31. The group-wide supervisor has appropriate responsibility for assessing the adequacy of the risk management and internal control systems, as mentioned above, on a group-wide basis and to ensure that the solo supervisors are able to cooperate effectively within the group context. It is the responsibility of the solo supervisor of each insurer to assess the adequacy of the systems for the business of that insurer. The group-wide supervisor should take into account the assessment made by the solo supervisors as far as relevant.

32. Close cooperation between solo supervisors and the group-wide supervisor is therefore required for the assessment of the adequacy of the internal control mechanisms at the group level and to ensure that senior management of the group is provided with relevant information on risks across the group.

4.3 Supervision and supervisory approach

Principle 4: Supervisors should have the skills and the appropriate authority to carry out supervision on a group-wide basis.

33. It is important that, in each jurisdiction, legislation is in place to grant the necessary power to the supervisor to adequately supervise groups based in its jurisdiction (see paragraph 24). A comprehensive system of group-wide supervision cannot be established on a global basis if the relevant supervisors do not have adequate powers.

34. This aim could be reached either by direct means where the supervisor has explicit authority and powers over the head of the group, or through the use of a follow-up approach where the supervisor has adequate power and authority over the regulated insurer to access information in respect of the head of the group.

35. At a jurisdictional level, it is important that legislation supports the supervisor of an insurer who is part of a group to appropriately contribute to the supervision of that group on a group-wide basis. For a group-wide supervisory approach, it is particularly important that legislation is in place in each jurisdiction to grant the necessary powers to the group-wide supervisor[5]. There need to be clear and transparent rules and guidelines determining designation of a group-wide supervisor. The group-wide supervisor may be the supervisor in the jurisdiction where the head of the group is based, as prescribed in such rules and guidelines[6].

36. Group-wide supervision should be undertaken effectively and efficiently, avoiding overlaps and deficiencies in supervision to the extent possible, while still preserving the overall supervisory objectives noted in paragraph 16. In this case, supervisors should have appropriate authority to facilitate cooperation and exchange of information with other involved supervisors (refer to Principle 5).

Principle 5: Necessary provisions and arrangements should be in place to allow efficient and effective supervision through cooperation and exchange of information among supervisors of the group.

37. To promote efficient and effective supervision of groups - in particular, cross-border groups - while avoiding unnecessary duplication and unreasonable regulatory burden, supervisors should establish adequate mechanisms to foster cooperation, promote communication and information exchange and facilitate enhanced coordination of group-wide supervision. Having such mechanisms in place would allow supervisors to place greater reliance on each other's work and hence avoid situations that can lead to unnecessary duplication of work or supervision; in particular, the case in which a group is simultaneously subject to several group-wide supervision processes at the same level in different jurisdictions by different supervisors.

38. There are various alternative methods available for streamlining group-wide supervision, which could be achieved through communication among the supervisors involved e.g. supervisory colleges or bilateral/multilateral dialogue. Alternatively, reliance on supervision by another supervisor, e.g. a group-wide supervisor, could be developed. A cooperation protocol that sets out general rules and responsibilities for group-wide and solo supervisors is another mechanism for fostering communication and cooperation. Provided the equivalence of supervisory action is safeguarded these various mechanisms may form the basis for mutual recognition amongst regulators.

[5] Please see Para.12. The requirement on supervision on a group-wide basis can be reached in two ways: at group level or through the legal entity.

[6] Please see Para.41-5. Further discussion will take place on the designation of the group-wide supervisor in the frame of the draft guidance paper on the role and responsibilities of a group-wide supervisor.

Communication and cooperation processes

39. The development of an efficient process for group-wide supervision requires cooperation arrangements that go beyond the reliance on the supervisor of the head of a group. Such recognition should be considered as a step towards establishing increased cooperation processes that closely involve the supervisors in charge of the different components of a group. Taking into account that the efficient supervision of internationally active complex groups requires a two-way flow of information, appropriate cooperation processes for achieving this need to be considered.

40. Regulatory cooperation includes insurance supervisors as well as other financial services regulators involved in the regulation of the insurance entities and other legal entities of the group.

Group-wide Supervisor

41. One of the ways of streamlining group-wide supervision would be for other supervisors to rely on the group-wide supervisor for key questions at group level (see Principles 1 to 3).

42. In principle, the supervisor in the jurisdiction where the head of a group is based and where that supervisor has the statutory responsibility to supervise the head of a group[7] would be considered as a group-wide supervisor. Experience has shown that it is generally clear who will be the group-wide supervisor; however, it may be that - depending on the structure of a particular group - several supervisors fulfil the conditions to be considered as group-wide supervisors. In such a case, it would be beneficial to set principles to reach an agreement to determine the group-wide supervisor and/or to streamline the roles of the relevant supervisors.

43. The group-wide supervisor approach and the principle of non-duplication will affect only the supervision of the group regarded as a whole; it will not prevent supervision at the relevant lower levels (legal entities or subgroups) by the respective supervisors in each jurisdiction.

44. A process of group-wide supervision requires, at a minimum, confidence among the supervisors involved and the conviction that the quality and level of supervision and enforcement is at least broadly equivalent in the respective jurisdictions. Further, under this approach the supervisors involved may need to agree upon supervisory tasks for the group to avoid unnecessary duplication of tasks (criteria (b) of ICP 17). When reasonably requested, the group-wide supervisor should be able to exchange with other supervisors relevant supervisory information, relevant financial data, and other important information, whether carried out under formal or informal agreements.

45. The tasks of the group-wide supervisor would be expected to include the assessment of:

- group structure and interrelationships, including ownership and management structure;
- capital adequacy at group level;
- reinsurance and risk concentration;
- intra-group transactions and exposures, including intra-group guarantees and possible legal liabilities; and

[7] Many countries have a definition of insurance holding company or mixed holding company. As head of groups these kinds of companies may be subject to some supervision.

- internal control mechanisms and risk management processes, including reporting lines and fit-and-proper testing of the board, senior management as well as the propriety of significant shareholders.

Supervisory College

46. Efficient and timely exchange of information among supervisory bodies is critical to effective and efficient supervision (criteria (c) of ICP17). Depending on the activities of a group and the jurisdictions where it is active, it may be more efficient for the group-wide supervisor to be backed by a more formal structure, such as a supervisory college. Where adopted, the composition of such a college needs to be considered, in particular whether it should include all the involved supervisors[8] or only the more relevant ones according to the risk profile of the group.

Further work of the IAIS

47. A key role for the IAIS is to facilitate the development of a framework of cooperation on group-wide supervision to help in streamlining comprehensive group-wide supervision. However, further discussion is needed in exploring and developing the options and various mechanisms discussed above. This paper is therefore a first step in the activity of the IAIS on group issues, and may need to be reviewed at a later stage to ensure consistency with future IAIS work in this area.

48. The IAIS has identified the issue of developing a framework of mutual recognition as a longer term objective. In the short term, the IAIS aims to develop standards and guidance which establish the basis for improved consistency between jurisdictions and convergence towards greater equivalency among supervisory regimes. In this way, the IAIS aims to facilitate an international supervisory environment where mutual recognition is a more practical option. The issues of mutual recognition will be addressed as part of a later stage in the IAIS work program.

[8] In the European Union the Co-ordination Committee includes all jurisdictions where the group has subsidiaries.

Excerpt IAIS Insurance Core Principles (ICP)

[Approved in Singapore on 3 October 2003]

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 cooperation 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).