Insurance Business (Risk Management, Capital Adequacy and Miscellaneous) Amendments Rules 2013

QFCRA Rules 2013-1

The Board of the Qatar Financial Centre Regulatory Authority makes the following rules, and gives the following guidance, under the *Financial Services Regulations*.

Dated 23 October 2013.

Abdulla Saoud Al-Thani
Chairman

Insurance Business (Risk Management, Capital Adequacy and Miscellaneous) Amendments Rules 2013

QFCRA Rules 2013-1

made under the

Financial Services Regulations

Contents

		Page
1	Name of rules	1
2	Commencement	1
3	Amendments	1
4	Explanatory notes	1
Schedule 1	**Amendments of the Insurance Business Rules 2006 (PINS)**	2
Part 1.1	**Substantive and consequential amendments**	2
Part 1.2	**Minor amendments**	65

page

Schedule 2 **Amendments of the Interpretation and Application Rules 2005 (INAP)** 67

1 Name of rules

These rules are the *Insurance Business (Risk Management, Capital Adequacy and Miscellaneous) Amendments Rules 2013*.

2 Commencement

These rules commence on 1 January 2015.

3 Amendments

These rules amend the *Rules* in schedule 1 and schedule 2.

4 Explanatory notes

An explanatory note in these rules is not part of these rules.

Schedule 1 Amendments of the Insurance Business Rules 2006 (PINS)

(see r 3)

Part 1.1 Substantive and consequential amendments

[1.1] Sections 2.1 to 2.4

substitute

Part 2.1 General

2.1.1 Application of ch 2

This chapter applies to every insurer (other than a QFC captive insurer).

2.1.2 Purpose of ch 2

The purpose of this chapter is to set out for an insurer:

(a) the requirements for the insurer's risk management strategy that are in addition to those set out in CTRL;

(b) the risks that must be specifically addressed in the insurer's risk management policy; and

(c) the requirement to conduct its own risk and solvency assessment.

Part 2.2 Risk management strategy

Note for pt 2.2

The requirements in this part are additional to those in CTRL, r 4.1.4, which sets out the general requirements for the risk management strategy of all authorised firms, including:

- processes for identifying, assessing, monitoring, managing and reporting on risks
- statements about the firm's risk tolerance and risk profile
- responsibilities and processes relating to risk management.

2.2.1 Additional requirements for insurer's risk management strategy

An insurer's risk management strategy must:

(a) address all material financial and non-financial risks to which the insurer is likely to be exposed;

(b) describe the relationships between the insurer's risk profile, risk tolerance, capital requirements and capital resources;

Note For this and the following paragraph, see in particular r 2.4.1 (1) and (2) on the insurer's own risk and solvency assessment.

(c) describe the policies, procedures and controls for monitoring risk;

(d) be supported by adequate risk management policies and procedures that explain the risks covered, the measurement approaches used and the key assumptions made;

(e) describe the processes for ensuring that the insurer's reinsurance arrangements are prudently and soundly managed;

(f) give an overview of the mechanisms for monitoring and ensuring compliance with the minimum capital requirement;

(g) describe how the insurer will:

(i) ensure that relevant staff have an awareness of risk issues and the accessibility of the risk management strategy; and

(ii) instil an appropriate risk culture; and

(h) describe a whole-of-business approach (***business continuity plan***) for ensuring that critical business operations can be maintained or recovered in a timely fashion in the event of disruption.

Note For the other matters that, in the Regulatory Authority's view, should be included in the insurer's risk management policy in relation to business continuity see r 2.3.1 (2) (e) and guidance S6.2 and S6.3.

2.2.2 Approval by governing body

(1) In giving its approval to an insurer's risk management strategy, or to changes to or deviation from the strategy, the governing body of the insurer must be satisfied that:

(a) the strategy and any changes to it mitigate and control the risks included in the insurer's risk management policy; and

(b) the risk management policy is appropriate and gives reasonable assurance that all material risks facing the insurer are prudently and soundly managed having regard to the nature, scale and complexity of the insurer's business.

Note 1 The governing body of an insurer is required to approve its risk management strategy (see CTRL, r 2.2.4) and any changes to, or deviation from, the strategy (see CTRL, r 4.1.4 (3) (d)).

Note 2 For the risks that must be included in an insurer's risk management policy, see r 2.3.1.

(2) An insurer must give to the Regulatory Authority a copy of its risk management strategy, and any subsequently amended version of that strategy, within 10 *business days* after its approval.

2.2.3 Intentional deviation not permitted

(1) An insurer must not intentionally deviate in a material way from its risk management strategy unless:

(a) the deviation has been approved by its governing body; and

(b) the insurer has given notice of the proposed deviation to the Regulatory Authority.

(2) An insurer must notify the Regulatory Authority of any material deviation at least 10 *business days* before the deviation.

(3) If necessary, an insurer must amend its risk management strategy after its governing body approves a material change to, or deviation from, the strategy.

Note CTRL, r 4.1.4 (4) requires an insurer to keep its risk management strategy up to date and to review it at least annually.

Part 2.3 Risk management policy

Note for pt 2.3

The risk management policy is part of, and supports, an insurer's risk management strategy; it lists and addresses the risks to which the insurer is likely to be exposed.

2.3.1 Contents of insurer's risk management policy

(1) An insurer's risk management policy must at a minimum address the following risks:

(a) credit risk;

(b) balance sheet and market risk (including investment, asset-liability management, liquidity and derivatives risks);

(c) reserving risk;

(d) insurance risk (including underwriting, product design, pricing and claims settlement risks);

(e) reinsurance risk;

(f) operational risk (including business continuity, outsourcing, fraud, technology, legal and project management risks);

(g) concentration risk;

(h) group risk.

Note 1 CTRL, r 2.2.3 requires authorised firms (including an insurer) to have strategic and business plans.

Note 2 The risk management policy must give reasonable assurance that the risks mentioned in this subrule are prudently and soundly managed (see r 2.2.2 (1) (b)).

(2) The insurer's risk management policy must include the following specific policies:

(a) a policy regarding investment that specifies the nature, role and extent of the insurer's investment activities and how the insurer complies with the investment requirements under these rules;

(b) a policy regarding asset-liability management that specifies the nature, role and extent of asset-liability management activities and their relationship with product development, pricing and investment management;

(c) a policy regarding underwriting that specifies the risks to be accepted by the insurer as part of its insurance business, the processes for underwriting, pricing and claims settlement;

(d) a policy ensuring that any reinsurance contract to which it is a party is finalised (and the material documents supporting the contract are completed):

(i) before the start of reinsurance cover (the ***start date***); or

(ii) as soon as possible after the start date (but in no case later than 60 days after the start date);

(e) a policy regarding procedures for business continuity that enable the insurer to manage any initial disruption of business and to recover critical business operations following such a disruption.

Note For the other matters that, in the Regulatory Authority's view, should be included in the insurer's risk management policy see sch 1, guidance S2.3 (investment risk), S2.5 (asset-liability management risk), S4.3 (underwriting risk), S5.2 (reinsurance risk) and S6.3 (business continuity risk).

(3) The policies of the insurer must be appropriate to the nature, scale and complexity of the insurer's business and the risks to which it is exposed.

(4) The definitions of the various risks must be clearly understood throughout the insurer so that its staff can effectively identify and manage the risks.

(5) Schedule 1 gives guidance about what, in the Regulatory Authority's view, should be included in the insurer's risk management policy.

Part 2.4 Own risk and solvency assessment

2.4.1 What is *ORSA*?

(1) ***Own risk and solvency assessment*** (***ORSA***) is a detailed forward-looking examination of:

(a) the adequacy of an insurer's risk management policies, procedures and controls; and

(b) the insurer's present and future solvency positions.

(2) The objectives of ORSA are:

(a) to assess:

(i) whether the insurer's own view of its solvency position is adequate given its risk profile and risk tolerance; and

(ii) whether its solvency position is likely to remain adequate in the foreseeable future;

(b) to show how the insurer proposes to manage (through capital buffers and other risk-mitigation mechanisms) the material risks to which it is exposed; and

(c) to identify potential business vulnerabilities.

Note 1 Because ORSA is part of an insurer's risk management strategy, the insurer must have regard to the other factors included in that strategy, including risk profile, tolerance and exposures, when conducting ORSA. For the same reason, the requirements that apply to risk management strategy (such as approval in r 2.2.2) also apply to ORSA.

Note 2 ORSA is both a management tool for the insurer's governing body and a supervisory tool to warn the Regulatory Authority of solvency issues.

(3) In conducting ORSA, the insurer must have regard to:

(a) its overall solvency needs, including its own view of the adequacy of its capital resources to meet the regulatory capital requirements;

(b) the actions it has taken to manage the risks to which it is exposed;

(c) the financial resources needed:

(i) to manage its business prudently; and

(ii) to meet the regulatory capital requirements;

(d) the nature and quality of the capital resources needed, having regard to their loss-absorbing capacity and liquidity;

(e) the effect on the insurer's solvency position of all reasonably foreseeable and relevant changes in its risk profile (including *group*-specific risks); and

(f) its ability to meet its minimum capital requirement and continue in business, and the financial resources needed, over

periods longer than those typically used for calculating the regulatory capital requirements.

Example

To gauge its ability to continue its business over longer periods, the insurer may use multi-year capital, cash-flow and balance sheet projections

(4) The insurer must include as part of any quantitative evaluation in ORSA:

(a) stress tests;

(b) the occurrence of extreme events to which the insurer is exposed; and

(c) other unlikely but possible adverse scenarios that would render the insurer's business model unviable.

Guidance

In addition to the scenarios in the guidance on stress testing in appendix 2, the insurer is expected to examine its policies, procedures, controls and solvency positions having regard to the following:

(a) the future adverse development of claims already notified;

(b) the uncertainty surrounding provisions for claims incurred but not yet reported;

(c) significant falls in the yields on supporting assets and investments to cover technical provisions;

(d) significant falls in the value of investments such as listed equity and real estate;

(e) significant increases in the likelihood of non-recovery of reinsurance contract assets, reinsurance receivables or cash bank deposits;

(f) the failure of a major counterparty such as a reinsurer, bank or client;

(g) the failure of an outsourcing partner (for example, a third-party administrator for a medical insurance business);

(h) significant deterioration in mortality and longevity experience for insurers conducting long-term insurance business.

2.4.2 Who must conduct ORSA?

(1) An insurer that is a *QFC entity* must conduct its ORSA annually.

Note An insurer that is a *branch* is not required to conduct ORSA.

(2) The assessment must be appropriate to the nature, scale and complexity of the insurer's business.

(3) The insurer's ORSA must include its own assessment of the capital resources needed to manage its business prudently and to continue to meet its insurance liabilities as they fall due, despite the existence of adverse scenarios.

Guidance

1 The methods for conducting ORSA (and making the report) will differ between insurers, but the methods do not necessarily have to be complex. The methods may range from simple stress tests and scenario analysis in a spreadsheet to more sophisticated economic capital models.

2 The Regulatory Authority expects the governing body of the insurer to use its own judgement to identify realistic adverse scenarios and to develop the rationale for the assumptions, data and methods used in the assessment.

3 Insurers are expected:

(a) to be transparent in their approach to ORSA; and

(b) to maintain records in a way that would enable a third party with sufficient knowledge to understand the assumptions, methods and conclusions.

2.4.3 ORSA report

(1) After an insurer conducts its ORSA, it must prepare a report that includes a statement that the governing body of the insurer participated in the assessment and approved the report.

(2) An insurer must prepare a revised ORSA report if there is a change to its risk management strategy, strategic plan or business plan and the change results, or there are reasonable grounds to believe that the change will result, in a material change in the capital adequacy or solvency of the insurer.

Note If an insurer becomes aware, or has reasonable grounds to believe, that an action would result in a material change in the capital adequacy or solvency of the insurer, it must tell the Regulatory Authority about the matter immediately (see *GENE*, r 4.1.3).

Guidance

1 The Regulatory Authority will discuss and evaluate the adequacy and prudence of the insurer's ORSA during the supervisory process. In particular, the authority will look into its adequacy when there is a material change in the insurer's risk management strategy, strategic plan or business plan.

2 If the assumptions or data used in an insurer's ORSA are inaccurate, inadequate or misleading, or if the Regulatory Authority considers that the underlying method is not sufficiently robust, the authority will require the insurer to conduct a new ORSA or to reconsider its report and prepare a revised report (see *GENE*, r 5.2.2).

Explanatory note

This amendment inserts rules that set out:

- the additional requirements for an insurer's risk management strategy
- the risks that must be addressed in its risk management policy and the inclusions and expectations in relation to those risks
- the requirement for an insurer to conduct its own risk and solvency assessment.

[1.2] Rule 3.1.1 guidance 3 and 4

substitute

Note This chapter does not apply to an insurer authorised to conduct insurance business in or from the QFC as a *branch*. Such an insurer will be subject to the regulatory capital requirements in the *jurisdiction* where it is incorporated.

Explanatory note

This amendment removes matters that are not guidance within the meaning of FSR, art 17, and substitutes a note for one of them.

[1.3] Rule 3.2.3, including guidance

omit

Explanatory note

This amendment removes a rule relating to what an insurer's systems and controls must contain.

[1.4] Sections 3.3 to 3.7

substitute

Part 3.3 Minimum capital requirement

3.3.1 What is an insurer's *MCR*?

The ***minimum capital requirement*** or ***MCR*** for an insurer is the higher of:

(a) US $10 million; and

(b) the insurer's risk-based capital requirement.

Note 1 The MCR is the lowest acceptable level of eligible capital below which policyholders would be exposed to unacceptable risks if the insurer were allowed to continue to operate.

Note 2 If the Regulatory Authority considers that a higher MCR is appropriate for an insurer, the authority may impose the higher requirement as a condition to the insurer's authorisation under FSR, art 31.

Note 3 An insurer will be in breach of r 1.2.2 if the insurer's eligible capital falls below its MCR. Under r 3.9.1 and r 3.9.2, an insurer must inform the Regulatory Authority of any possible breach or actual breach of r 1.2.2.

3.3.2 Obligations relating to MCR

(1) An insurer must immediately inform the Regulatory Authority if its eligible capital falls below its MCR.

Note For the requirements regarding quarterly reporting, see r 1.4.1.

(2) If an insurer's eligible capital falls below its MCR, the insurer must immediately stop effecting new contracts of insurance.

Guidance on intervention by Regulatory Authority

1 As soon as the Regulatory Authority becomes aware that an insurer's eligible capital has fallen below its MCR, the authority will confer with the insurer about what needs to be done next.

2 If the insurer's eligible capital falls below its MCR, the authority will intervene by, for example:

(a) requiring the insurer to immediately increase its eligible capital;

(b) suspending the insurer's business;

(c) placing the insurer's business in run-off; or

(d) withdrawing the insurer's authorisation.

3.3.3 Other action not prevented

Nothing in this chapter prevents the Regulatory Authority from taking any other action under the FSR or these or any other rules against the insurer in relation to its capital adequacy.

Note Under FSR, art 31, the Regulatory Authority may take, on its own initiative, action against the insurer. The authority may also take disciplinary action under FSR, pt 9.

Part 3.4 Risk-based capital requirement

3.4.1 What is an insurer's *risk-based capital requirement*?

(1) The ***risk-based capital requirement*** for an insurer that, under rule 3.8.1 (a), has been approved to use its own internal model to calculate its risk-based capital requirement is the amount calculated using that model.

(2) The ***risk-based capital requirement*** for an insurer that, under rule 3.8.1 (b), has been approved to use its own internal model to replace 1 or more components of its investment, insurance and operational risk requirements is the amount calculated using those components as replaced and the other components of the insurer's investment, insurance and operational risk requirements.

(3) The ***risk-based capital requirement*** for any other insurer is the sum of the insurer's:

(a) investment risk requirement;

(b) insurance risk requirement; and

(c) operational risk requirement.

Part 3.5 Investment risk requirement

3.5.1 What is an insurer's *investment risk requirement*?

An insurer's ***investment risk requirement*** is the sum of its:

(a) asset risk component;

(b) off-balance sheet asset risk component; and

(c) off-balance sheet liability risk component.

Note Appendix 3 sets out the method for calculating each component of the *investment risk requirement*.

Part 3.6 Insurance risk requirement

3.6.1 What is an insurer's *insurance risk requirement*?

An insurer's ***insurance risk requirement*** is the sum of its:

(a) premium risk component;

(b) technical provision risk component;

(c) long-term insurance risk component; and

(d) insurance concentration risk component.

Note Appendix 3 sets out the method for calculating each component of the insurance risk requirement.

Part 3.7 Operational risk requirement

3.7.1 What is an insurer's *operational risk requirement*?

(1) The amount of an insurer's ***operational risk requirement*** (***ORR***) is 2% of whichever is the higher of:

(a) the insurer's gross written premiums in the 12 months ending on the solvency reference date; and

(b) its technical provisions (without deduction for reinsurance) as at the solvency reference date.

(2) However, if the amount calculated under subrule (1) is more than a ***ceiling***, calculated as:

$$(Investment\ risk\ requirement + Insurance\ risk\ requirement)\times\left(\frac{0.15}{0.85}\right);$$

then the insurer's ORR is the amount of the ceiling.

Note The ceiling for ORR is calibrated such that an insurer's ORR cannot be higher than 15% of its risk-based capital requirement.

Explanatory note

This amendment:

- makes amendments to the minimum capital requirement for an insurer
- removes the concept of 'base capital requirement' now that the requirement is to have a single amount of US $10 million
- gives guidance about when an insurer can expect the Regulatory Authority to intervene in matters of the insurer's capital adequacy
- adds to the insurer's risk-based capital requirement a capital charge for the operational risk requirement
- clarifies the use of internal models

- removes unnecessary guidance
- inserts an insurance concentration risk component in the calculation of an insurer's insurance risk requirement.

[1.5] Rules 3.8.1 and 3.8.2

substitute

3.8.1 Approval by Regulatory Authority

The Regulatory Authority may, by written notice, allow an insurer to use its own internal model:

(a) to calculate its risk-based capital requirement; or

(b) to replace a component or components of its investment risk requirement, insurance risk requirement and operational risk requirement.

Explanatory note

This amendment clarifies the role of the Regulatory Authority in relation to the use by an insurer of internal models relating to the calculation of risk.

[1.6] Rule 4.6.4 (E)

omit

Explanatory note

This amendment removes from inadmissible assets certain debts owed to the insurer that are more than 90 days overdue.

[1.7] Rule 4.8.2 guidance

omit

Explanatory note

This amendment is consequential on the removal rule 3.2.3 by another amendment.

[1.8] Chapter 8

omit everything before rule 8.2.1

insert

Chapter 8 Matching and valuing assets and liabilities of insurers

Part 8.1 General

8.1.1 Application of ch 8

This chapter applies to every insurer (other than a QFC captive insurer).

8.1.2 Purpose of ch 8

The purpose of this chapter is to set out rules for:

(a) matching an insurer's assets with its liabilities;

(b) the consistent valuation of those assets and liabilities; and

(c) investment concentration limits of insurers that are limited liability companies incorporated under the Companies Regulations 2005; and

(d) the use of derivatives.

Guidance

This chapter is not intended to establish a basis of accounting for general purpose financial statements of insurers. It does not prevent an insurer from adopting a method of valuing assets and liabilities that might be considered excessively prudent if used in the insurer's financial statements.

8.1.3 Value of insurer's assets to match its insurance liabilities

(1) An insurer must hold supporting assets of a value at least equal to the amount of its insurance liabilities.

(2) The assets:

(a) must have characteristics of safety, yield and marketability that are appropriate to the nature, scale and complexity of the insurer's business;

(b) must be diversified;

(c) must be adequately spread; and

(d) must be of a sufficient amount, and of an appropriate currency and term, to ensure that the cash inflows from the assets meet the expected cash outflows from the insurer's insurance liabilities as they fall due.

(3) In determining the expected cash outflows for subrule (2) (d), the insurer must take into account any options that exist in the insurer's contracts of insurance.

(4) This rule does not apply to assets held to cover index-linked liabilities.

(5) However, this rule applies to assets held to cover the guaranteed portion of any index-linked long-term insurance contract that includes a guarantee of investment performance or some other guaranteed benefit.

8.1.4 Asset admissibility and investment criteria

(1) An insurer may invest in assets and instruments only if the insurer:

(a) can identify, measure, monitor, manage and report on the risks arising from the assets and instruments; and

(b) can take those risks into account in the assessment of its solvency needs in accordance with these rules.

(2) Investments must be made by the insurer in such a way:

(a) as to ensure the security, quality, liquidity and profitability of its portfolio of assets; and

(b) as to avoid:

(i) over-reliance or concentration on a particular asset class, region, issuer or group of issuers; and

(ii) excessive accumulation of risk in the portfolio.

(3) Assets and securities that are not admitted to trading on a regulated financial market must be kept to prudent levels.

(4) Assets held by the insurer to cover technical provisions must be invested:

(a) as appropriate to the nature and duration of its insurance liabilities;

(b) in the best interest of all policyholders and beneficiaries; and

(c) taking into account any policy objectives disclosed by the insurer.

Guidance

For investments of assets held by an insurer to cover technical provisions, the Regulatory Authority expects the investments to be made in liquid assets like:

1 cash and cash-equivalent instruments;

2 time deposits;

3 readily tradable securities;

4 shares in publicly listed companies;

5 liquid corporate or sovereign bonds.

8.1.5 Use of derivatives

(1) An insurer must not use a derivative instrument for speculation or proprietary trading.

(2) An insurer may use a derivative instrument:

(a) to mitigate or reduce financial risks;

(b) for sound hedging; or

(c) for efficient portfolio management.

8.1.6 Investment concentration limits for companies

(1) For an insurer that is a limited liability company incorporated under the Companies Regulations 2005, investments representing a concentration of exposures to single or related counterparties (whether on or off-balance sheet and including intra-*group* entities) must not exceed whichever is the lesser of the following amounts:

(a) 20% of the insurer's applicable assets;

(b) the insurer's eligible capital.

Example

An insurer's deposits in the same bank will be subject to the investment concentration limit because it is an exposure to a single counterparty.

(2) ***Applicable assets*** of an insurer means the insurer's total assets less reinsurance receivables, premiums receivables, deferred acquisition

costs, fixed assets, intangible assets and other assets that are not held for investment purposes.

Example

In calculating the value of applicable assets, items such as deferred tax assets, prepayments, advances and accrued income should be deducted from the insurer's total assets.

(3) Assets that are excluded from eligible capital in accordance with paragraph (G) of the table in rule 4.2.2 are not subject to the concentration limit.

Part 8.2 Measuring assets and liabilities

Explanatory note

This amendment introduces:

- rules for matching supporting assets and insurance liabilities
- asset admissibility criteria and a 'prudent person' test for investments of an insurer
- rules on the use of derivatives.

[1.9] After rule 8.4.4

insert

8.4.5 Derecognising liabilities

(1) An insurance liability (or a part of an insurance liability) must not be derecognised until the obligation giving rise to the liability expires or is discharged or cancelled.

(2) To avoid doubt, if reinsurance covering the liability (or part of the liability) is purchased, the liability must not be derecognised unless the purchase results in the discharge or cancellation of the obligation giving rise to the liability.

Explanatory note

This amendment clarifies at what point liabilities arising out of insurance contracts cease to be part of the insurer's liabilities.

[1.10] Section 8.5

substitute

Part 8.5 Discount rate

8.5.1 Calculating liabilities

In calculating the present value of an insurance liability, the discount rate must be a prudent estimate of the yield expected to be earned by assets of the insurer that are sufficient in value and appropriate in nature to cover the provisions for the liability being discounted.

Guidance

The Regulatory Authority expects that the insurer, in its approach to estimating a suitable yield for the discount rate, will have adequate regard to the profile of the liabilities (for asset-liability matching purposes) and the quality of the assets backing those liabilities.

Explanatory note

This amendment replaces the rate of discount for measuring expected payments.

[1.11] Rules 8.6.2 to 8.6.6

omit

Explanatory note

This amendment removes provisions relating to the treatment of certain premiums and expenses in general insurance business

[1.12] Rules 8.7.2 to 8.7.8

omit

Explanatory note

This amendment removes provisions relating to the treatment of certain premiums and expenses in long-term insurance business

[1.13] Rule 8.7.11

omit everything before subparagraph (C) (i)

insert

8.7.11 Measuring net value of policy benefits as liability

In measuring the liability mentioned in rule 8.7.10, the insurer must:

(a) use actuarial principles;

(b) provide for all liabilities based on assumptions that meet the general requirements for prudent assumptions in rule 8.8.1 (including appropriate margins for adverse deviation of relevant factors that are sufficient to ensure that there is no significant foreseeable risk that liabilities to policyholders for long-term insurance contracts will not be met as they fall due); and

(c) take into account:

Explanatory note

This amendment states in paragraph (b) what are prudent assumptions for, and what constitutes appropriate margins for adverse deviation in, measuring liabilities.

[1.14] After rule 8.7.14

insert

8.7.15 Negative values for reserves—long-term insurance

An insurer must not calculate a negative value for its mathematical reserves for a long-term insurance contract unless:

(a) the calculation is based on assumptions that meet the general requirements for prudent assumptions in rule 8.8.1;

(b) the contract does not have a guaranteed surrender value at the actuarial valuation date; and

(c) the total mathematical reserves established by the insurer have a value of at least:

(i) if the insurer's long-term insurance contracts include linked long-term contracts—the sum of the surrender values of all its linked long-term contracts at the actuarial valuation date; and

(ii) in any other case—zero.

Part 8.8 Methods, assumptions and projections

8.8.1 Methods and assumptions that may be used

In measuring long-term insurance business liabilities, an insurer must use methods and prudent assumptions that:

(a) are appropriate to the nature, scale and complexity of the insurer's business;

(b) are made using professional judgement, training and experience;

(c) are made having regard to reasonably available statistics and other information;

(d) are neither deliberately overstated nor deliberately understated;

(e) are consistent from year to year and without arbitrary changes;

(f) are consistent with the insurer's method of valuing assets;

(g) include appropriate margins for adverse deviation of relevant factors;

(h) recognise the distribution of profits or emerging surplus in an appropriate way over the duration of each contract of insurance; and

(i) are in accordance with generally accepted actuarial practice.

8.8.2 Projecting cash flows

In projecting cash flows in relation to its long-term insurance business, an insurer must take into account the nature of the projections and the factors relevant to its insurance business, including:

(a) expected investment earnings;

(b) expected reinsurance recoveries;

(c) mortality and morbidity;

(d) expenses;

(e) options and guarantees; and

(f) persistency.

Guidance

1 Investment earnings—If the cash flow to be valued depends on future investment earnings, the assumption for investment earnings should reflect the expected investment earnings applicable to the assets on which the cash flows depend.

2 Reinsurance—An insurer should value reinsurance cash flows using methods and assumptions that are at least as prudent as the methods and assumptions used to value the underlying contracts of insurance that have been reinsured.

3 Mortality and morbidity—Assumptions about mortality and morbidity should use prudent rates of mortality and morbidity that are appropriate to the country or territory of residence of the persons whose life or health are insured.

4 Expenses—An insurer should make provisions for expenses, implicitly or explicitly, in its mathematical reserves of an amount that is no less that the amount expected, on prudent assumptions, to be incurred in carrying out its long-term insurance contracts.

5 Options and guarantees—If an insurer establishes its mathematical reserves for a long-term insurance contract, the insurer should include an amount to cover:

(a) any increase in liabilities that might be the direct result of the policyholder exercising an option under that contract, and

(b) all vested, declared or allocated bonuses to which policyholders are collectively or individually entitled under their contracts.

If the surrender value of a contract is guaranteed, the amount of the mathematical reserves for that contract at any time should be at least equal to the value guaranteed at that time.

6 Persistency—Assumptions about voluntary discontinuance rates in the calculation of the mathematical reserves may be made if the assumptions meet the general requirements for prudent assumptions in rule 8.8.1.

Explanatory note

This amendment inserts:

- in rule 8.7.15 the conditions that must be met before an insurer may calculate a negative value for its mathematical reserves for a long-term insurance contract
- in part 8.8 the methods, assumptions and factors that an insurer must use in measuring liabilities and projecting cash flows.

[1.15] Chapter 10

substitute

Chapter 10 Insurers that are members of groups

10.1.1 Application of ch 10

This chapter applies to every insurer (other than a QFC captive insurer) that is a member of a *group*.

10.1.2 Purpose of ch 10

This chapter imposes additional requirements on an insurer that is a member of a *group* to ensure that:

(a) the insurer is capitalised adequately to protect itself against the risks arising from its membership of the *group*, and is otherwise protected against those risks;

(b) it can be properly supervised by the Regulatory Authority;

(c) it provides the authority with information about the structure and financial position of the *group*; and

(d) it assesses the effect of, and notifies the authority of, certain transactions within the *group*.

Guidance

1 An insurer is exposed to risks through the relationships that it has with other insurance and non-insurance companies in its *group*.

2 An insurer is also subject to reporting requirements in relation to changes in its controllers. Those requirements are set out in *GENE*. Under *GENE*, an insurer may also be required to provide reports in relation to any *close links* it has.

10.1.3 Ch 10 in addition to other Regulatory Authority powers

A power of the Regulatory Authority under this chapter is in addition to the authority's other powers.

10.1.4 Powers under FSR not affected

Nothing in this chapter affects:

(a) the Regulatory Authority's powers under FSR, article 31, to take action to protect the interests of an insurer's policyholders or the *financial system*; or

(b) its powers under FSR, article 48, to obtain documents and information.

10.1.5 Group structure

(1) The structure of the insurer's *group* must be transparent and must not hinder the effective supervision of the insurer.

(2) The structure and risk profile of the *group* must not hinder the insurer's stability and solvency.

(3) The overall governance, high-level controls and reporting lines within the *group* must be clear so far as they affect the insurer.

Example

The insurer must not be subject to material control or influence from another *group* member that is exercised through informal or undocumented channels.

(4) There must be clear and certain protocols for the performance of functions for the insurer at the *group* level.

Guidance

The senior management of an insurer that is a member of a *group* remains responsible for its regulatory compliance, even if parts of it are delegated or outsourced to other *group* members (see CTRL, pt 2.3).

10.1.6 Direction regarding capital resources

(1) If the Regulatory Authority considers that an insurer should hold additional capital (above the amount of capital that the insurer would otherwise be required by these rules to hold) to cover risks arising because of the insurer's *group* membership, the authority may direct the insurer to increase its capital:

(a) to an amount; and

(b) within a period;

that the authority specifies in the direction.

Example of when Regulatory Authority might give direction regarding capital resources

The Regulatory Authority might impose an additional restriction or requirement on an insurer:

- if the *group* is conducting an intra-*group* transaction that may adversely affect the solvency or financial position of the insurer
- if there are risks that arise from the existence of a non-regulated entity within or connected to the *group* and may adversely affect the solvency position of the insurer
- risk transfer or reinsurance arrangements within the *group* that impose disproportionate risks on the insurer.

(2) A direction under subrule (1) may specify that the additional capital is to take a particular form.

(3) An insurer must comply with a direction under subrule (1).

10.1.7 Intra-group transactions

(1) An insurer must ensure that any material transaction with another member of its *group*:

(a) is entered into on an ‘arm’s-length’ basis; and

(b) is on fair and reasonable terms.

Guidance

A single transaction or series of connected transactions that constitute a sale, purchase, exchange, loan or extension of credit, investment or guarantee involving 0.5% or less of an insurer’s eligible capital as at the end of the last standard quarter (the standard quarters end on 31 March, 30 June, 30 September and 31 December) before the effective date of the transaction would not normally be considered material for the purposes of this rule.

(2) The insurer must ensure that its books, accounts and records clearly and accurately disclose the nature and details of the transaction, including any accounting information necessary to demonstrate that the terms were fair and reasonable.

10.1.8 Certain transactions to be inquired into by insurer's governing body

(1) An insurer that is incorporated in the QFC must not enter into a transaction of a kind described in subrule (2) unless its *governing body* is satisfied, after reasonable inquiry, that the transaction does not adversely affect the interests of policyholders.

Note The *Governance and Controlled Functions Rules 2012*, r 2.2.2 (1) (a), requires the *governing body* of an authorised firm to be mindful of the legitimate interests of policyholders and other stakeholders when making decisions.

(2) The kinds of transaction are the following:

(a) an intra-*group* transaction (including a sale, purchase, exchange, loan, guarantee or investment) the amount of which is 3% (or more) of the insurer's eligible capital;

(b) a loan to a *person* not *related* to the insurer, if there is an agreement or understanding that the proceeds of the loan, or a substantial part of those proceeds, will be used to make loans to purchase assets of, or make investments in, another *group* member, and the amount of the loan is 3% (or more) of the insurer's eligible capital;

(c) an intra-*group* reinsurance agreement, or a modification to such an agreement, if the reinsurance premium or change in the insurer's liabilities is 5% (or more) of the insurer's eligible capital;

(d) a reinsurance agreement, or a modification to such an agreement, involving the transfer of assets from the insurer to a *person* not *related* to it, if:

(i) there is an agreement or understanding between the insurer and that *person* that any part of the assets will be transferred to 1 or more other *person*s *related* to the insurer; and

(ii) the reinsurance premium or change in the insurer's liabilities is 5% (or more) of the insurer's eligible capital;

(e) an intra-*group* management agreement, service contract or cost-sharing arrangement.

(3) A reference in subrule (2) to an insurer's eligible capital is a reference to that capital as at the end of the last standard quarter before the relevant transaction.

(4) An insurer's *governing body* may delegate its responsibility under subrule (1) to the insurer's senior management if the insurer's risk management strategy and internal control framework permit the *governing body* to do so.

(5) In this rule:

loan includes the extension of credit.

standard quarter means each 3-month period ending on 31 March, 30 June, 30 September and 31 December.

10.1.9 Directions about certain intra-group matters

(1) The Regulatory Authority may give an insurer a direction in relation to any of the following matters:

(a) the insurer's treatment of intra-*group* transactions;

(b) the insurer's treatment of risk concentration within the *group*;

(c) supervisory reporting and disclosure of information by the insurer;

(d) any other matter relevant to the supervision of the insurer.

Example of when Regulatory Authority might give direction

The Regulatory Authority might impose an additional restriction or requirement on an insurer:

- if the *group* is conducting an intra-*group* transaction that may adversely affect the solvency or financial position of the insurer
- if there are risks that arise from the existence of a non-regulated entity within or connected to the *group* and may adversely affect the solvency position of the insurer
- risk transfer or reinsurance arrangements within the *group* that impose disproportionate risks on the insurer.

(2) An insurer must comply with a direction under subrule (1).

10.1.10 Notices to provide information about group financial resources

(1) The Regulatory Authority may, by written notice, require an insurer to give it, within 90 days or a stated shorter reasonable period, a statement of the consolidated financial position of the insurer's *group*, made up:

(a) as at a date specified in the notice, and

(b) in accordance with principles stated in the notice.

Guidance

An insurer would normally be allowed to comply with a notice under rule 10.1.10 by providing a copy of a statement made up in compliance with an equivalent or substantially equivalent regulatory requirement to which the insurer or a *subsidiary* or *associate* is subject in another *jurisdiction*. If the statement is not in English, the insurer must also provide a certified translation of the statement into English (see *GENE*, r 5.1.2).

(2) The Regulatory Authority may, by written notice, require an insurer to give it, within 90 days or a stated shorter reasonable period, information about any of the following:

(a) another entity or other entities in the insurer's *group*;

(b) the structure of its *group*;

(c) the relationships between entities in its *group*;

(d) the procedures and controls to manage group risk in the *group*;

(e) any other matter relevant to the supervision of the insurer.

Example of when Regulatory Authority might require additional information

The Regulatory Authority might require an insurer to give it additional information:

- if the *group* is conducting an intra-*group* transaction that may adversely affect the solvency or financial position of the insurer
- if there are risks that arise from the existence of a non-regulated entity within or connected to the *group* and may adversely affect the solvency position of the insurer.

(3) An insurer must comply with a requirement under subrule (1) or (2).

Note See FSR, art 48 (Power to obtain documents and information).

Explanatory note

This amendment introduces new requirements for an insurer that is a member of a group.

[1.16] Appendix 1

substitute

Schedule 1 Guidance about what should be included in insurer's risk management policy

(see r 2.3.1 (5))

Note for sch 1

This schedule sets out in detail what the Regulatory Authority expects to see in an insurer's risk management policy. Each part deals with a risk that the insurer is required to address under r 2.3.1 by first describing the risk and then stating what, in the authority's view, should be included in the policy in relation to the risk.

Part S1 Credit risk

S1.1 What is *credit risk?*

(1) ***Credit risk*** is:

(a) the risk of default by debtors, borrowers and other counterparties; and

(b) the risk of the loss of value of assets due to deterioration in their credit quality.

(2) Credit risk results from financial transactions with debtors, borrowers, securities issuers, brokers, policyholders, reinsurers and guarantors.

(3) Credit risk includes on-balance-sheet and off-balance-sheet exposures from guarantees, derivative contracts and performance-related obligations to counterparties. It can increase the risk profile of an insurer and can adversely affect the insurer's financial viability.

S1.2 Risk management policy—credit risk

(1) An insurer's risk management policy for credit risk should include:

(a) a mandate setting out the acceptable range, quality and diversification of credit exposures (including those to reinsurers, brokers and policyholders) and investments;

(b) limits for credit exposures at individual and consolidated levels to:

(i) single counterparties and groups of *related* counterparties;

(ii) intra-*group* asset exposures to subsidiaries and related entities;

(iii) single industries; and

(iv) single regions;

(c) a process for approving changes in the credit mandate and changes in limit structures;

(d) a process for approving requests for temporary increases in limits and a process to ensure excesses are brought within the pre-approved limits within a set timeframe;

(e) a process for reviewing and, if necessary, reducing or cancelling exposures to a particular counterparty if it is known to be experiencing problems;

(f) a process to monitor and control credit exposures against pre-approved limits;

(g) a process to review credit exposures (at least annually, but more frequently if there is evidence of a deterioration in credit quality);

(h) a management information system that is capable of aggregating exposures to any one counterparty (or group of *related* counterparties), asset class, industry or region in a timely manner; and

(i) a process of reporting to the governing body and senior management:

(i) any breaches of limits; and

(ii) large exposures and other credit risk concentrations.

(2) Actual and potential credit exposures to reinsurers arising from current or possible future claims should be included in the insurer's risk management policy.

Part S2 Balance sheet and market risk

S2.1 What is *balance sheet and market risk*?

Balance sheet and market risk includes:

(a) investment risk;

(b) asset-liability management risk;

(c) liquidity risk; and

(d) derivatives risk.

S2.2 What is *investment risk*?

(1) ***Investment risk*** is the risk of an adverse movement in the value of an insurer's assets, including off-balance-sheet exposures.

(2) Investment risk includes:

(a) equity risk;

(b) interest rate risk;

(c) foreign exchange risk;

(d) credit risk; and

(e) investment concentration risk.

(3) Because of the nature of insurance business, there is a close relationship between investment risk and asset-liability management risk.

S2.3 Risk management policy—investment risk

(1) An insurer's risk management policy for investment risk should include:

(a) the insurer's investment objective;

(b) formulation of an investment strategy, including allowable asset classes, strategic asset allocation, asset allocation ranges, benchmarks, risk limits and target currency exposures and ranges;

(c) a process for how individual asset classes will be managed, including which of those tasks will be done internally and which will be outsourced to investment managers;

(d) the responsibilities of individuals and committees within the insurer (such as the investment committee and the asset-liability committee) for deciding and implementing the investment strategy, and for monitoring and controlling investment risk, including reporting lines, decision-making powers and delegations;

(e) a process for the selection of qualified and competent investment managers;

(f) limits and other restrictions on the actions of investment managers, whether internal or outsourced, and the means by which compliance with those limits are monitored;

(g) modelling and stress-testing of the effect of the current and alternative investment strategies on financial outcomes and asset-liability management;

(h) processes for:

(i) ensuring the continuing appropriateness of the investment strategy, including the timing and nature of strategy reviews;

(ii) ensuring the continuing appropriateness of the investment implementation process, including the timing and nature of reviews of investment managers and the manager configuration;

(iii) monitoring compliance with the investment strategy; and

(iv) making contingency plans to mitigate the effects of deteriorating investment conditions;

(i) the segregation of duties; and

(j) performance monitoring and its role in the oversight and control of the investment process.

(2) For paragraph (1) (b), the investment strategy should be formulated taking account of the investment objective, the insurer's capital position, the term and currency profile of its expected liabilities, liquidity requirements and the expected returns, volatilities and correlations of asset classes.

S2.4 What is asset-liability management risk?

(1) ***Asset-liability management risk*** is the risk of an adverse movement in the relative values of assets and liabilities of an insurer due to changes in general market factors, such as interest rates, inflation and, if relevant, foreign exchange rates.

(2) The expected payment profile of an insurer's liability portfolios is a crucial part of asset-liability management, because it determines the exposure of the portfolios' value to interest rates. Property business, such as household insurance, is typically short-term. Liability business, such as public liability, is typically long-term. The interest rate sensitivity of assets and liabilities is broadly determined by the timing of cash flows, although that will not always be the case (for example, in the case of floating-rate notes or options).

(3) Assets and liabilities are well managed if their changes in value in response to market movements are highly correlated. If assets and liabilities are not well managed, the possibility of a reduction in asset value that is not offset by a reduction in liability value, or an increase in liability value that is not offset by an increase in asset value, becomes significant.

(4) Because of the nature of insurance business, there is a close relationship between investment risk and asset-liability management risk.

S2.5 Risk management policy—asset-liability management risk

An insurer's risk management policy for investment risk should include details about how:

(a) the insurer's investment and liability strategies allow interaction between assets and liabilities;

(b) the correlations between assets and liabilities are taken into account;

(c) cash outflows to policyholders and other creditors will be met by cash inflows; and

(d) the valuations of assets and liabilities will change under an appropriate range of scenarios.

S2.6 What is *liquidity risk*?

(1) ***Liquidity risk*** is the risk of the insurer not having sufficient cash or liquid assets to meet its cash outflows to policyholders and other creditors as they fall due.

(2) The nature of insurance activities means that the timing and amount of cash outflows are uncertain. This uncertainty may affect the ability of an insurer to meet its obligations to policyholders or require an insurer to incur additional costs through, for example, raising additional funds at a premium on the market or through the sale of assets.

S2.7 Risk management policy—liquidity risk

An insurer's risk management policy for liquidity risk should include:

(a) consideration of the level of mismatch between expected asset and liability cash flows under normal and stressed operating conditions;

(b) the liquidity and realisability of assets;

(c) commitments to meet insurance and other liabilities;

(d) the uncertainty of the incidence, timing and magnitude of insurance liabilities;

(e) the level of liquid assets required to be held by the insurer; and

(f) other sources of funding, including reinsurance, borrowing capacity, lines of credit and intra-*group* funding.

S2.8 What is *derivatives risk*?

Derivatives risk is the risk from transactions in derivative instruments such as forwards, *futures*, swaps, *options*, *contracts for differences* and other similar instruments.

S2.9 Risk management policy—derivatives risk

An insurer's risk management policy for derivatives risk should include:

(a) the insurer's objectives and policies in using derivatives;

(b) a framework with limits on the use of derivatives consistent with the insurer's risk tolerance;

(c) appropriate lines of authority and responsibility for transacting derivatives, including trading limits;

(d) consideration of worst-case scenarios and sensitivity analysis; and

(e) a process for reporting of scenarios and analysis.

Part S3 Reserving risk

S3.1 What is *reserving risk*?

(1) ***Reserving risk*** is the risk that the reserves set aside by the insurer for its insurance liabilities (net of reinsurance and other recoveries for those liabilities) will be inadequate to meet the net amount payable when the insurance liabilities crystallise.

(2) In this part, ***insurance liabilities*** includes:

(a) the liability for claims incurred up to the reporting date;

(b) the premium liability; and

(c) for long-term insurance business—the net value of future policy benefits and reinsurance recoveries anticipated for those liabilities.

S3.2 Risk management policy—reserving risk

(1) An insurer's risk management policy for reserving risk should include:

(a) a process for the ongoing review and appraisal of the insurance liability valuation framework (including the assumptions made and reinsurance recoveries estimated);

(b) procedures and controls to ensure that the provision for insurance liabilities is, at all times, sufficient to cover any liabilities that have been incurred, or are yet to be incurred, on contracts of insurance accepted by the insurer, as far as can reasonably be estimated;

(c) the methods to be applied in estimating the provision for insurance liabilities, including provisions for individual notified incurred claims;

(d) the methods to be applied in estimating the amount of the asset for reinsurance recoveries that are expected to arise on crystallisation of the gross insurance liabilities (the manner of estimating those assets must be consistent with the manner of estimating the gross liabilities, unless there is a sound justification for doing otherwise);

(e) procedures and controls to ensure that the selected approaches are applied accurately and consistently;

(f) procedures to review and monitor, on a regular basis, the out-turn of provisions made in previous years for insurance liabilities (gross and net of reinsurance recoveries);

(g) procedures to ensure that in-house or external specialists selected have the appropriate level of skill and experience and have available the necessary information to carry out the estimation required;

(h) suitable controls to ensure that the data used in determining the insurance liabilities are extracted from the underlying records accurately and to the necessary level of detail; and

(i) scenario testing for several years into the future, particularly for an insurer conducting long-term insurance business.

(2) For paragraph (1) (a), in conducting a review and appraisal of the insurance liability valuation framework, consideration should be given to emerging pricing and claim payment trends.

(3) For paragraph (1) (c), in determining a provision estimation method, an insurer may consider alternative approaches before selecting those regarded as most appropriate to the nature of the business.

(4) For paragraph (1) (h), the level of detail of the data used in determining the insurance liabilities should be sufficient to ensure that the data available covers the whole of the insurer's liabilities and exposures under insurance contracts.

(5) In addition to the actuarial advice an insurer is required to obtain under chapter 9, an insurer should consider the use of actuaries or other appropriately qualified and experienced loss reserving specialists to estimate insurance liabilities periodically through the year.

(6) The insurer should undertake periodic testing of its reserving processes and the level of its reserves, including continual reassessment of assumptions used, and testing the sensitivity of the valuation of insurance liabilities to stress arising from realistic scenarios relevant to the circumstances of the insurer.

Part S4 Insurance risk

S4.1 What is *insurance risk*?

Insurance risk is the risk that inadequate or inappropriate underwriting, product design, pricing and claims settlement will expose an insurer to financial loss and consequent inability to meet its liabilities.

S4.2 What is *underwriting risk*?

(1) ***Underwriting risk*** is the risk arising from the process by which an insurer determines:

(a) whether or not to accept a risk; and

(b) the terms and conditions to be applied, and the premium to be charged, if the risk is accepted.

(2) Weaknesses in underwriting and in its procedures and controls can expose an insurer to the risk of operational losses that may threaten its solvency position.

S4.3 Risk management policy—underwriting risk

An insurer's risk management policy for underwriting risk should include:

(a) a statement of the insurer's willingness and capacity to accept risk;

(b) the nature of insurance business that the insurer is to underwrite including:

(i) classes of insurance;

(ii) the areas where it conducts business;

(iii) the types of risks included and excluded; and

(iv) the criteria for the use of reinsurance in the different classes of insurance;

(c) details of the formal risk assessment process in the underwriting of insurance, including:

(i) the criteria used for risk assessment; and

(ii) the methods for monitoring emerging experience; and

(iii) the methods by which the emerging experience is taken into consideration in the underwriting process; and

(d) the process for setting approval authorities and the limits to those authorities (including controls surrounding delegations given to intermediaries of the insurer);

(e) risk and aggregate concentration limits; and

(f) methods for monitoring compliance with policies and procedures regarding underwriting, such as:

(i) internal audit (but only if it is established that the internal audit function has the appropriate skills and experience to perform such activities);

(ii) reviews by area heads or portfolio managers;

(iii) peer review of policies (including details of the staff responsible for undertaking the peer review, the frequency of such reviews and the reporting arrangements for the results); and

(iv) in the case of reinsurers—audits of ceding companies to ensure that reinsurance assumed is in accordance with contracts in place.

S4.4 What is *product design risk*?

Product design risk, in relation to an insurance product, means the risk arising from:

(a) the introduction of a new insurance product; or

(b) the enhancement or variation of an existing insurance product.

S4.5 Risk management policy—product design risk

An insurer's risk management policy for product design risk should include:

(a) the product classes and types of risks in which the insurer chooses to engage;

(b) setting a business case for new or enhanced products;

(c) market testing and analysis;

(d) cost-benefit analysis;

(e) requirements for limiting risk through measures such as diversification, exclusions and reinsurance (including confirmation that the existing reinsurance will provide protection or new reinsurance protection is being provided);

(f) processes to ensure that policy documentation is adequately drafted to give legal effect to the proposed level of cover under the product;

(g) an implementation plan for the product, including milestones;

(h) clearly defined and appropriate levels of delegation for approval of all material aspects of product design;

(i) post-implementation review; and

(j) methods for monitoring compliance with product design policies and procedures.

S4.6 What is *pricing risk*?

Pricing risk, in relation to an insurance product, means the risk arising from inaccurately estimating:

(a) the claims and other business costs arising from the product; and

(b) the income from the investment of the premium received for the product.

S4.7 Risk management policy—pricing risk

(1) An insurer's risk management policy for pricing risk should include:

(a) clearly defined and appropriate levels of delegation for approval of all material aspects of pricing;

(b) a process for the reflection of emerging experience in price adjustments;

(c) profit-loss analysis, including monitoring the effect of price movements; and

(d) price discounting authorities;

(e) a process for the insurer's product pricing to respond to competitive and other external environmental pressures;

(f) a process for monitoring, and the ability to monitor, deviations of actual price from the technical underwriting pricing;

(g) methods for monitoring compliance with pricing policies and procedures for proposed pricing variations; and

(h) the relationship between pricing, product development and investment management so that they are appropriately aligned.

(2) The Regulatory Authority expects insurers to consider doing the following in relation to pricing insurance products:

(a) incorporating ongoing actuarial review of, and actuarial involvement in, the pricing process;

(b) undertaking independent reviews of:

(i) pricing for schemes; and

(ii) pricing for larger or more complex risks.

S4.8 What is *claims settlement risk*?

(1) ***Claims settlement risk*** is the risk arising from the process by which insurers fulfil their contractual obligations to policyholders.

(2) The claims settlement process is triggered when a loss occurs and a claims notification is made to the insurer. The process begins with verifying the contractual obligation to pay the claim under the policy, and is followed by:

(a) an assessment of the amount of the liability (including loss adjustment expenses); and

(b) the prompt and efficient handling of the claim within the terms of the policy.

(3) Weaknesses in claims settlement and in its procedures and controls can expose an insurer to additional or increased losses that may threaten its solvency position.

S4.9 Risk management policy—claims settlement risk

An insurer's risk management policy for claims settlement risk should include:

(a) clearly defined and appropriate levels of delegation of authority;

(b) claims settlement procedures and controls, including loss estimation and investigation procedures;

(c) criteria for accepting or rejecting claims;

(d) dispute resolution procedures; and

(e) methods for monitoring compliance with claims settlement procedures, such as:

(i) internal audit (but only if it is established that the internal audit unit has the appropriate skills and experience to perform such activities);

(ii) reviews by area heads or portfolio managers;

(iii) peer review (including details of the staff responsible for undertaking the peer review, the frequency of such reviews and the reporting arrangements for the results);

(iv) assessments of brokers' procedures and systems to ensure that the quality of information provided to the insurer is of a suitable standard; and

(v) in the case of reinsurers—audits of ceding companies to ensure that the value of claims paid is in accordance with contracts.

Part S5 Reinsurance risk

S5.1 What is *reinsurance risk*?

Reinsurance risk is the risk that the reinsurance cover obtained by the insurer is inadequate.

S5.2 Risk management policy—reinsurance risk

An insurer's risk management policy for reinsurance risk should include:

(a) the insurer's objectives (within its risk tolerance) for reinsurance management;

(b) the process for selection of reinsurance brokers and advisers;

(c) the processes for prudent and sound selection, management and monitoring of its reinsurance programme;

(d) managerial responsibilities and controls;

(e) the methods for determining all aspects of a reinsurance programme, including:

(i) identification and management of aggregations of risk exposures;

(ii) selection of probable maximum loss factors;

(ii) selection of realistic adverse scenarios, return periods and geographical aggregation areas; and

(iv) identification and management of vertical and horizontal coverage of the programme;

(f) the process for ensuring that there is accurate and complete reinsurance documentation;

(g) the selection of participants in reinsurance contracts, including the criteria and procedures to ensure, and monitor, their diversity and creditworthiness;

(h) the procedures for identifying actual and potential credit exposures to individual reinsurers or groups of connected reinsurers on programmes that are already in place; and

(i) the processes for entering into a limited risk transfer arrangement.

Part S6 Operational risk

S6.1 What is *operational risk*?

(1) ***Operational risk*** is the risk of financial loss resulting from:

(a) inadequate or failed internal processes, people and systems; or

(b) external events.

(2) Operational risk includes:

(a) business continuity risk;

(b) technology risk;

(c) outsourcing risk;

(d) fraud risk;

(e) legal risk;

(f) project management risk; and

(g) any other risks that the insurer, having regard to its strategic plan and business plan, and the nature, scale and complexity of the insurer's business and operating environment, determines should be included.

S6.2 What is *business continuity risk*?

(1) ***Business continuity risk*** is the risk of unexpected financial and non-financial losses (such as loss of data, premises and reputation) due to disruptions in an insurer's critical business operations.

(2) Disruptions may occur as a result of power failure, denial of access to work areas, fire, fraud, loss of key staff, failure of computer or data system, destruction of major equipment and security breaches arising from technology risk.

Note CTRL, r 4.1.4 (3) (c) requires an insurer to include, in its risk management strategy, contingency planning, business continuity, crisis management and fraud management. Under CTRL, r 2.2.8 an insurer must review its business continuity procedures at least once every 18 months.

(3) ***Critical business operations*** are the business functions, resources and infrastructure that may, if disrupted, have a material impact on the insurer's business functions, reputation, profitability and policyholders.

S6.3 Risk management policy—business continuity risk

An insurer's risk management policy for business continuity risk should:

(a) describe the process for identifying and analysing:

(i) events that may lead to a disruption in business continuity;

(ii) the likelihood of those events occurring;

(iii) the processes most at risk; and

(iv) the consequences of those events;

(b) include a plan (***business continuity plan*** or ***BCP***) describing:

(i) objectives and procedures for crisis management and recovery in order to minimise financial, legal, regulatory, reputational and other material consequences arising from the disruption of its business;

(ii) procedures to be followed if business continuity problems arise;

(iii) detailed procedures for carrying out the BCP, including manual processes, the activation of an off-site recovery site (if needed) and the persons responsible for activating the BCP;

(iv) a communications strategy and contact information for relevant staff, suppliers, regulators, market authorities, major clients, the media and other key staff;

(v) a schedule of critical systems covered by the BCP and the timeframe for restoring those systems;

(vi) the pre-assigned responsibilities of staff;

(vii) procedures for staff awareness and training on all aspects of the BCP; and

(vii) procedures for regular testing and review of the BCP; and

(c) procedures for backing up important data on a regular basis and storing the data off site.

S6.4 What is *technology risk*?

(1) ***Technology risk*** is risk:

(a) that arises from the use of communication information technology infrastructure; and

(b) that generates events that may lead to the disruption or damage of an insurer's information systems or data.

(2) Technology risk is determined by the type and nature of threats targeting and affecting the insurer's environment. Insurers rely heavily on technologies such as the internet and applications. In a highly interconnected and market-driven world, an insurer should have a reliable, flexible, complete and integrated set of operating processes to deal with technology risks.

S6.5 Risk management policy—technology risk

An insurer's risk management policy for technology risk should include:

(a) information technology policies and procedures to identify, assess, monitor and manage technology risks;

(b) arrangements for adequate information technology infrastructure that:

(i) meet its current and projected business requirements (both under normal circumstances and in periods of stress);

(ii) ensure data and system integrity, security and availability; and

Example

The IT infrastructure is able to keep secure, and protect, personal information and data (including financial and medical data) in accordance with the requirements under the Data Protection Regulations 2005 and any other relevant laws.

(iii) support integrated and comprehensive risk management;

(c) the use of appropriate technology to manage adequately the financial, medical and personal information held by an insurer;

(d) procedures and controls on data security to enable it:

(i) to report, in a timely manner, security breaches to affected customers and to the Regulatory Authority; and

(ii) to meet other reporting requirements;

(e) processes to assess the risks associated with major breaches in data security and to mitigate the effects of such breaches on its resources, operations, environment and operations;

(f) as part of business continuity planning, measures to be taken in case of breaches of data security; and

(g) measures that ensure that *group* structures are not used to circumvent prohibitions on the sharing of personal information.

S6.6 What is *outsourcing risk*?

(1) ***Outsourcing risk*** is the risk posed to an insurer's business by non-performance, or poor performance, by a service provider of a function transferred to the service provider under a material outsourcing arrangement (within the meaning of CTRL).

(2) An insurer should not outsource a function if the outsourcing would result in unduly increasing the operational risk of the insurer.

Note An insurer must assess the risks that an outsourcing poses to its business (see CTRL, r 5.2.1 (2) (b)) and the governing body of the insurer must review, at least once every 2 years, the insurer's outsourcing procedures for assessing the feasibility of a proposed outsourcing and the risks that the outsourcing poses to the insurer's business (see CTRL, r 5.1.2 (4) (a) (i)).

(3) Financial firms frequently decide to outsource aspects of their operations to other parties, *related* or not. Outsourcing can bring significant benefits to an insurer in terms of efficiency, cost reduction and risk management. However, the process of implementing outsourcing arrangements and the outsourcing relationship itself may expose an insurer to additional risk. It is therefore important that insurers take care to supervise the conduct of activities that are outsourced.

Note CTRL, r 5.2.3 (1) requires an authorised firm to inform the Regulatory Authority before entering into a material outsourcing arrangement.

(4) The activities of service providers have the ability to undermine the risk management activities of insurers. Insurers should take particular care in the outsourcing of activities such as underwriting and claims settlement, where

inappropriate performance of the functions can expose the insurer to serious financial loss, for example through acceptance of inappropriate insurance risks, mis-pricing, failure to obtain appropriate reinsurance cover, or failure to detect invalid claims. These considerations apply to such arrangements as binding authorities and other agencies appointed by insurers.

(5) Insurers should take care to manage the risk that the sound and prudent management of the insurer's business may be compromised by conflicting incentives in an outsourcing agreement. In particular, insurers should consider whether the remuneration structure creates any perverse incentives. For example, a service provider with underwriting authority may have an incentive to accept poorer quality business if remuneration is based on commission (especially if bonuses are given for volume) but is not affected by the performance of the insurance contracts accepted.

(6) Intra-*group* outsourcing may be perceived as subject to lower risks than using service providers from outside a *group*. However it is not risk-free and an insurer must still assess the associated risks and make appropriate arrangements for their management.

S6.7 Risk management policy—outsourcing risk

An insurer's risk management policy for outsourcing risk should include:

(a) a process for negotiating or assessing outsourcing agreements with service providers;

(b) the setting and monitoring of authority limits and referral requirements;

(c) the identification and assessment of performance targets;

(d) the procedures for evaluation of performance against targets;

(e) the provisions for remedial action;

(f) the reporting requirements imposed on the service providers (including content and frequency of reports);

(g) the ability of the insurer and its external auditors to obtain access to the service providers and their records;

(h) the protection of intellectual property rights;

(i) the protection of customers' and the insurer's confidentiality;

(j) the adequacy of any guarantees, indemnities or insurance cover that a service provider agrees to provide;

(k) the ability of a service provider to provide continuity of business; and

(l) the arrangements to change, or terminate, outsourcing agreements.

S6.8 What is *fraud risk*?

(1) ***Fraud risk*** means:

(a) risk from unauthorised activities such as those that breach the controls, procedures, limits or other restrictions in an insurer's policies and procedures and in legal and regulatory requirements; or

(b) risk associated with:

(i) a deceptive act or omission intended to gain advantage for the party committing the fraud or other parties; or

(ii) an intentional act undertaken for personal gain or to tamper with or manipulate the financial or operational aspects of the business.

(2) Fraud risk exposes an insurer to financial losses if not managed properly.

(3) Fraud risk can result from:

(a) internal sources (such as redirection of premiums); and

(b) external sources (such as fictitious claims).

(4) Countering fraud is the concern of individual insurers and intermediaries who need to understand, and minimise their vulnerability to, fraud

S6.9 Risk management policy—fraud risk

An insurer’s risk management policy for fraud risk should include:

(a) internal controls and mitigation strategies;

(b) segregation of duties at an operational level and in relation to functional reporting lines;

(c) financial accounting controls;

(d) staff training and awareness; and

(e) appropriate processes for monitoring compliance with the insurer’s procedures, controls, limits or other restrictions (such as those placed on investment managers or those making decisions on underwriting).

S6.10 What is *legal risk*?

(1) ***Legal risk*** is the risk of an insurer being exposed to losses, penalties or reputational damage due to breaches of laws or regulatory obligations, inadequate reinsurance or other contracts, or changes in the laws affecting the insurer.

Example of inadequate contracts

Reinsurance contracts that expose the insurer to significant legal risk because:

(a) the contract is not valid, binding or enforceable;

(b) the contract does not clearly set out the respective rights and obligations of the parties; or

(c) a policy document inadequately sets out what exclusions apply.

(2) Legal risk includes risks arising from:

(a) fines, penalties or punitive damages from supervisory actions or civil litigation;

(b) legal costs from litigation; and

(c) expenses arising from private settlements.

S6.11 Risk management policy—legal risk

An insurer’s risk management policy for legal risk should include:

(a) processes for ensuring that documentation is accurate and complete;

(b) processes to ensure that policies are adequately drafted so that the insurer does not have to pay out for risks not priced into the original premium; and

(c) procedures and controls for ensuring that the insurer complies with all legal, prudential and other regulatory requirements.

S6.12 What is *project management risk*?

Project management risk is the risk that projects involving an insurer will not achieve the desired objectives or will have a negative effect on the adequacy of resources.

S6.13 Risk management policy—project management risk

An insurer's risk management policy for project management risk should include:

(a) a method for the promulgation of project initiatives including:

(i) setting a business case for the project;

(ii) cost-benefit analysis of the project; and

(iii) stakeholder sign-offs;

(b) clearly defined and appropriate levels of delegation of authority;

(c) ongoing monitoring of project objectives and timeframes; and

(d) post-implementation review.

Part S7 Concentration risk

S7.1 What is *concentration risk*?

(1) ***Concentration risk*** is the risk of over-reliance on, or excessive exposure to, a type of risk, counterparty, asset class, industry or region as a result of credit, balance sheet and market, reserving, insurance, reinsurance, operational and group risks.

(2) Concentration risk results from risk exposures with a loss potential that is large enough to threaten the solvency position of an insurer.

(3) An insurer's exposure to risks should not result in a concentration of risks that could result in losses so large as to threaten its solvency position.

S7.2 Risk management policy—concentration risk

An insurer's risk management policy for concentration risk should include:

(a) identification of large risk exposures;

(b) a description of the way in which large risk exposures are being managed, controlled and mitigated by the insurer;

(c) a description of any limits put in place by the insurer to control concentration risk;

(d) identification of on-balance sheet and off-balance sheet exposures to concentration risk;

(e) risk management procedures in relation to concentration risk; and

(f) processes to ensure that the insurer's exposures to large potential losses due to concentration risk are in line with its risk tolerance.

Part S8 Group risk

S8.1 What is *group risk*?

(1) ***Group risk*** is the risk of loss to an insurer as a result of its membership of a *group* or linkages within a *group*.

(2) *Group* membership can be a source of both strength and weakness for an insurer.

(3) The purpose of requiring an insurer that is a member of a *group* to include group risk in its risk management policy is to ensure that the insurer takes proper account of the risks arising from its membership.

S8.2 Risk management policy—group risk

If an insurer is a *branch*, or part of a *group*, the insurer's risk management policy for group risk should:

(a) include a summary of the *group* policy objectives and strategies;

(b) state whether the local risk management strategy is derived wholly or partly from the *group*-wide risk management strategy;

Note The governing body of an insurer must know the implications for the insurer of any *group*-wide risk management strategy (see CTRL, r 4.1.5 (4)).

(c) summarise the linkages and significant differences between the local risk management strategy and the *group*-wide risk management strategy, including differences arising from local business and other conditions;

(d) outline the procedures and timing for monitoring by, or reporting to, the *parent entity* or head office;

(e) describe the approach to reviews of the procedures in paragraph (d);

(f) include, if applicable, a summary of the *group* policy objectives and strategies relating to reinsurance;

(g) summarise the linkages between local and *group* reinsurance; and

(h) detail any arrangements relating to the existence of, and accessibility to, intra-*group* reinsurance.

(2) If a part of an insurer's risk management policy is controlled by another entity in the *group*, or by the head office, the risk management policy must describe the arrangement and how it works.

(3) If the insurer is a *branch* or is part of an insurance *group* and the head office or ultimate *holding company* is outside the QFC, the risk management policy should

include a summary of the supervisory arrangements regarding risk management in the *jurisdiction* where the head office or *holding company* is located.

S8.3 Specific obligations of group members

(1) If an insurer is a member of a *group*, the insurer's senior management should monitor any functions performed for the insurer at the *group* level.

Examples

- group risk management
- capital planning
- liquidity
- compliance.

(2) The insurer's senior management should establish and maintain procedures and controls to identify and monitor the effect on the insurer of its relationship with the other members of the group and the activities of those other members.

(3) The procedures and controls should include procedures to monitor:

(a) changes in relationships between *group* members;

(b) changes in the activities of *group* members;

(c) conflicts of interest arising within the *group*;

(d) events in the *group*, particularly those that might affect the insurer's own regulatory compliance (for example, any failure of control or compliance in another *group* member);

(e) the effect on it of:

(i) its relationship with the other members of the *group*;

(ii) its membership in the *group*; and

(iii) the activities of the other members of the *group*; and

(f) the *group's* compliance with:

(i) the supervision requirements applicable to it, including systems for the production of relevant data; and

(ii) *group* reporting requirements.

(4) The insurer should have procedures to insulate it, so far as practicable, from the adverse effects of other *group* activities (for example, transfer pricing or fronting) or *group* events that might expose the insurer to risk.

Examples

Such procedures could include:

- a requirement for transactions within the *group* to be at arm's length
- maintenance of "*Chinese walls*"
- development of contingency plans.

(5) The insurer's senior management should take reasonable steps to ensure that:

(a) other *group* members are aware of the insurer's management and reporting obligations in relation to group risk;

(b) *group* capital and group risk reporting requirements are complied with; and

(c) information about the *group* provided to the Regulatory Authority is accurate, and is provided in a timely manner.

Explanatory note

This amendment substitutes a more structured set of guidance about what the Regulatory Authority expects to be included in an insurer's risk management policy.

[1.17] Appendix 3 guidance

omit

Explanatory note

This amendment removes unnecessary guidance that has wrong cross references.

[1.18] Appendix 3, table A3.1.1

substitute

Table A3.1.1 Grade of assets according to counterparty ratings

Item	Rating of counterparty by:				Grade of asset
	Standard & Poor's	Moody's	A. M. Best	Fitch	
1	AAA	Aaa	A++	AAA	1
2	AA+ AA AA-	Aa1 Aa2 Aa3	A+	AA+ AA AA-	2
3	A+ A A-	A1 A2 A3	A A-	A+ A A-	3
4	BBB+ BBB BBB-	Baa1 Baa2 Baa3	B++ B+	BBB+ BBB BBB-	4

Item	Rating of counterparty by:				Grade of asset
5	BB+ or below	Ba1 or below	B or below	BB+ or below	5

(3) Unrated assets, exposures and counterparties must be classified as grade 4.

A3.1.2 Using different credit rating agencies

(1) An insurer must rely on the ratings issued by the same credit rating agency for determining counterparty grades unless the insurer has good reason to use a different credit rating agency or agencies.

Examples of good reasons

1 If the rating agency usually used by the insurer does not issue a solicited credit rating for a particular debt obligation and only 1 other rating agency issues a solicited credit rating for the debt obligation

2 If the rating agency usually used by the insurer does not issue a solicited credit rating for a particular debt obligation, any credit ratings issued by the other rating agencies in table A3.1.1 must be considered and the procedure in rule A3.1.2 (2) used to determine which rating agency will be used.

(2) If a counterparty or debt obligation has been rated by more than 1 rating agency and there are 2 or more ratings that lead to different capital charges, the insurer must use the credit rating that results in the highest capital charge.

(3) An insurer must not use the rating of an agency that is not in table A3.1.1 unless the insurer has the written permission of the Regulatory Authority.

Explanatory note

This amendment recalibrates the grade of assets using counterparty ratings and introduces rules on the use of credit rating agencies.

[1.19] Appendix 3, section A3.2

omit everything before rule 3.2.2

insert

Part A3.2 Asset risk component

Guidance

1. Asset risk is the risk of loss if:
   (a) another party fails to perform its financial obligations to the insurer (including failing to perform them in a timely manner); or
   (b) there is an adverse movement in the value of an insurer's invested assets that is not offset by a corresponding movement in the value of liabilities.
2. Asset risk includes an insurer failing to collect premiums due from customers or a reinsurer failing to fulfil its financial obligation to repay an insurer upon submission of a claim.
3. The purpose of the asset risk component is to require an insurer to hold capital against these risks and potential unexpected losses. The basic calculation for this component in rule A3.2.1 is modified by additional provisions that permit an insurer to take account of reduced credit risk (for example, where an asset is covered by guarantees or collateral). Invested assets that are linked to liabilities of investment-linked insurance contracts are exempted from the calculation, since there is a direct correlation between the values of the assets and the values of the liabilities to which they are linked.

A3.2.1 *Asset risk component*

(1) An insurer's ***asset risk component*** is the sum of the amounts obtained by multiplying the value of each asset of the insurer, graded according to the counterparty *grade* of the asset, by the percentage applicable to that asset, under:

(a) for assets that are not reinsurance assets—table A3.2.1A;

(b) for assets that are reinsurance assets where the reinsurer is subject to prudential supervision by a subrule (2) regulator—table A3.2.1B; or

(c) for assets that are reinsurance assets where the reinsurer is not subject to prudential supervision by a subrule (2) regulator—table A3.2.1C.

(2) A regulator is a ***subrule (2) regulator*** if it is located:

(a) in Qatar;

(b) in one of the member states of the European Union;

(c) in Australia, Canada, Hong Kong, Iceland, Japan, Norway, Singapore, Switzerland, the United States of America; or

(d) in any other *jurisdiction* that is a signatory to the *Multilateral Memorandum of Understanding on Cooperation and Information Exchange* initiated by the International Association of Insurance Supervisors.

Note 1 For the list of the member states of the European Union, see http://europa.eu/about-eu/countries/index_en.htm.

Note 2 For the list of signatories to the *Multilateral Memorandum of Understanding on Cooperation and Information Exchange*, see http://www.iaisweb.org/MMoU-signatories-605.

Table A3.2.1A Percentage applicable to assets that are not reinsurance assets

Item	Asset	%
1	cash, bank deposits and other cash equivalents grade 1 sovereign bonds	0.50
2	bonds that mature, or are redeemable, in less than 1 year issued by a counterparty with a rating of grade 1 or 2 (excluding subordinated debt and government debt obligations dealt with anywhere else in this table) cash management trusts with a counterparty rating of grade 1 or 2	1.00
3	unpaid premiums due 6 months or less previously from a counterparty with a rating of grade 1, 2 or 3 bonds that mature, or are redeemable, in 1 year or more issued by a counterparty with a rating of grade 1 or 2 (excluding subordinated debt and government debt obligations dealt with anywhere else in this table)	2.00

Item	Asset	%
4	unpaid premiums due 6 months or less previously from an unrated counterparty or a counterparty with a rating of grade 4 or 5 bonds issued by a counterparty with a rating of grade 3 (excluding subordinated debt) cash management trusts with a counterparty rating of grade 3 secured loans	4.00
5	unpaid premiums due more than 6 months previously from a counterparty with a rating of grade 1, 2 or 3 bonds issued by a counterparty with a rating of grade 4 (excluding subordinated debt) cash management trusts with a counterparty rating of grade 4	6.00
6	unpaid premiums due more than 6 months previously from an unrated counterparty or a counterparty with a rating of grade 4 or 5 bonds issued by a counterparty with a rating of grade 5 (excluding subordinated debt) cash management trusts with a counterparty rating of grade 5 listed subordinated debt	8.00
7	unlisted subordinated debt preference shares	10.00

Item	Asset	%
8	listed equity investment listed trusts	16.00
9	direct holdings of real estate unlisted equity investment unlisted trusts	20.00
10	loans to: (a) directors of the insurer; (b) directors of *related* parties; or (c) dependent relatives of such directors unsecured loans to employees (except loans of less than US $1,000) assets subject to a fixed or floating charge	100.00
11	other non-reinsurance assets not mentioned in this table	20.00

Note ***Equity investment*** is defined in the glossary.

Table A3.2.1B Percentage applicable to reinsurance assets—reinsurer supervised by subrule (2) regulator

Item	Asset	%
1	reinsurance assets due from reinsurers with a counterparty rating of grade 1	1.00
2	reinsurance assets due from reinsurers with a counterparty rating of grade 2	2.00
3	reinsurance assets due from reinsurers with a counterparty rating of grade 3	4.00
4	reinsurance assets due from reinsurers with a counterparty rating of grade 4	6.00

Item	Asset	%
5	reinsurance assets due from reinsurers with a counterparty rating of grade 5	8.00

Table A3.2.1C Percentage applicable to reinsurance assets—reinsurer not by supervised by subrule (2) regulator

Item	Asset	%
1	reinsurance assets due from reinsurers with a counterparty rating of grade 1	1.20
2	reinsurance assets due from reinsurers with a counterparty rating of grade 2	2.40
3	reinsurance assets due from reinsurers with a counterparty rating of grade 3	4.80
4	reinsurance assets due from reinsurers with a counterparty rating of grade 4	7.20
5	reinsurance assets due from reinsurers with a counterparty rating of grade 5	9.60

Explanatory note

This amendment merges into the asset risk component the former credit risk component and volatility risk component and recalibrates the percentages for assets. It also introduces a new rule to reflect higher capital charges for reinsurance recovery assets due from reinsurers subject to prudential supervision by *overseas regulators* located in jurisdictions that have not signed the *Multilateral Memorandum of Understanding on Cooperation and Information Exchange* initiated by the International Association of Insurance Supervisors or that may not apply equivalent prudential standards.

[1.20] Appendix 3, rules A3.2.2 and A3.2.3

omit

credit risk charge

insert

asset risk charge

Explanatory note

The amendment is consequential on the combination of credit risk component and volatility risk component into asset risk component.

[1.21] Appendix 3, rule A3.2.4

substitute

A3.2.4 Excluded assets

An insurer need not include an amount in the asset risk charge for any asset excluded from eligible capital in accordance with the table in rule 4.2.2.

Explanatory note

This amendment is consequential on the combination of credit risk component and volatility risk component into asset risk component.

[1.22] Appendix 3, section A3.3

omit

Explanatory note

This amendment is consequential on the combination of credit risk component and volatility risk component into asset risk component.

[1.23] Appendix 3, rule A3.4.3

omit

derivative, as determined in Rule A3.4.4 is multiplied by the credit risk component as determined in Rule A3.2.1 and the volatility risk component as determined in Rule A3.3.1, as

insert

derivative (as determined in rule A3.4.4) is multiplied by the asset risk component as

Explanatory note

This amendment is consequential on the combination of credit risk component and volatility risk component into asset risk component.

[1.24] Appendix 3, rule A3.5.1 (1)

omit

issued, including letters of credit, guarantees and put options serving as guarantees, the credit risk component as determined in Rule A3.2.1 and the volatility risk component as determined in Rule A3.3.1, that

insert

issued (including letters of credit, guarantees and put options serving as guarantees) the asset risk component that

Explanatory note

This amendment is consequential on the combination of credit risk component and volatility risk component into asset risk component.

[1.25] Appendix 3, section A3.6

omit

Explanatory note

This amendment omits the concentration risk component as a consequence of the new concentration limits in rule 8.1.6.

[1.26] Appendix 3, section A3.7 to section A3.9

substitute

Part A3.7 Premium risk component

Guidance

An insurer may be exposed to the risk that the cost of future claims in respect of general insurance business will exceed the cost implicit in the premiums being charged. The purpose of the premium risk component is to require an insurer to hold capital against this risk in accordance with the calculations set out in rule A3.7.1. The basic calculation model in rule A3.7.1 applies different factors to the premium in respect of each PINS category, based on the different perceived risk of variability associated with each.

A3.7.1 Application of pt A3.7

This part applies to general insurance business.

A3.7.2 *Premium risk component*

(1) An insurer's ***premium risk component*** is the sum of the amounts obtained by multiplying the insurer's net premium liability that falls within each PINS category by the percentage applicable to that liability under table A3.7.2.

Table A3.7.2 Percentage factor—premium risk component

Item	PINS Category	Direct insurance %	Reinsurance: proportional %	Reinsurance: non-proportional %
1	PINS category 1	16	18	21
2	PINS category 2	13	15	18
3	PINS category 3	16	18	21
4	PINS category 4	21	23	26

(2) In this rule:

net premium liability means premium liability less any expected reinsurance and non-reinsurance recoveries in respect of that premium liability as at the solvency reference date.

Note ***Premium liability*** is defined in r 8.6.7 and ***solvency reference date*** is defined in the glossary.

A3.7.3 Insurer may apply for different percentages

(1) The Regulatory Authority may, on application of an insurer conducting business in PINS category 1, give written consent to the use of percentages other than those in table A3.7.2 if the authority is satisfied that:

(a) adequate mortality and morbidity information exists in respect of that business; and

(b) the information provides a reasonable basis for reliance on actuarial principles.

(2) The percentages that may be used must be those stated in the notice but may not be lower than:

(a) 12% in the case of direct insurance and proportional reinsurance; and

(b) 16% in the case of non-proportional reinsurance.

A3.7.4 Certain contracts not included

(1) If an insurer underwrites contracts of insurance in PINS category 1 that are long-term insurance contracts, the insurer need not calculate a premium risk component in respect of those contracts.

(2) For contracts of insurance in PINS category 1 that are long-term insurance contracts, the insurer must calculate a long-term insurance risk component.

Part A3.8 Technical provision risk component

Guidance

An insurer may be exposed to the risk that the cost of claims in respect of general insurance business will exceed the amounts recorded as liabilities in the insurer's balance sheet. The purpose of the technical provision risk component is to require an insurer to hold capital against this risk in accordance with the calculations set out in rule A3.8.2. This calculation only applies to liabilities in respect of outstanding claims (premium liabilities addressed in the premium risk component in part A3.7).

A3.8.1 Application of pt A3.8

This part applies to general insurance business.

A3.8.2 *Technical provision risk component*

(1) An insurer's ***technical provision risk component*** is the sum of the amounts obtained by multiplying the insurer's net liability for outstanding claims that falls within each PINS category by the percentage applicable to that liability under table A3.8.2.

Table A3.8.2 Percentage factor—technical provision risk component

Item	PINS Category	Direct insurance %	Reinsurance: proportional %	Reinsurance: non-proportional %
1	PINS category 1	11	12	14

Item	PINS Category	Direct insurance %	Reinsurance: proportional %	Reinsurance: non-proportional %
2	PINS category 2	9	10	12
3	PINS category 3	11	12	14
4	PINS category 4	14	15	17

(2) In this rule:

net liability for outstanding claims means the liability in respect of future claims referred in rule 8.6.8, less any expected reinsurance and non-reinsurance recoveries in respect of that liability as at the solvency reference date.

Note ***Solvency reference date*** is defined in the glossary.

A3.8.3 Insurer may apply for different percentages

(1) The Regulatory Authority may, by written notice, allow the insurer to use percentages other than those in table A3.8.2 if the authority is satisfied that:

(a) adequate mortality and morbidity information exists in respect of that business; and

(b) the information provides a reasonable basis for reliance on actuarial principles.

(2) The percentages that may be used must be those stated in the notice but may not be lower than 8%.

A3.8.4 Certain contracts not included

(1) If an insurer underwrites contracts of insurance in PINS category 1 that are long-term insurance contracts, the insurer need not calculate a technical provision risk component in respect of those contracts.

(2) For contracts of insurance in PINS category 1 that are long-term insurance contracts, the insurer must calculate a long-term insurance risk component.

Part A3.9 Long-term insurance risk component

Guidance

The purpose of the long-term insurance risk component is to require an insurer to set aside capital to address the risk that the net present value of future policy benefits will vary from the amounts recorded as long-term insurance liabilities in the insurer's balance sheet.

A3.9.1 Application of pt A3.9

This part applies to long-term insurance business.

A3.9.2 *Long-term insurance risk component*

An insurer's ***long-term insurance risk component*** is the sum of the following amounts, so far as they relate to the long-term insurance business of the insurer:

(a) 1.25% of the amount of provisions in respect of long-term insurance business that is investment-linked insurance, where the contracts are subject to a capital guarantee;

(b) 0.5% of the amount of provisions in respect of long-term insurance business that is investment-linked insurance, where the contracts are not subject to a capital guarantee;

(c) 3% of the amount of provisions in respect of long-term insurance business other than business described in paragraphs (a) and (b);

(d) the amount obtained by multiplying the amount of capital at risk under rule A3.9.3 by 0.1%;

(e) if the insurer issues policies that are contingent on mortality—the amount of anticipated claims cost arising from a 0.5 per thousand increase in the rate of lives insured dying over the following year.

A3.9.3 *Capital at risk*

(1) ***Capital at risk*** of an insurer means the total amount of sums assured on long-term insurance contracts issued by the insurer, less:

(a) the total amount of mathematical reserves for those contracts; and

(b) any expected reinsurance and non-reinsurance recoveries as at the solvency reference date.

(2) For an annuity, the sum assured must be taken to be the present value of the annuity payments.

(3) The contribution of each contract to capital at risk must be determined separately. If the capital at risk calculated for a contract is less than zero, the capital at risk for that contract is taken to be zero.

Part A3.10 Insurance concentration risk component

A3.10.1 Application of pt A3.10

This part applies to general insurance business.

Note For a QFC insurer that carries on long-term insurance business, the capital charge relating to possible insurance concentration risk is included in the long-term insurance risk component in part A3.9.

Guidance

1 An insurer is exposed to the possibility of very large losses arising from its portfolio as a result of exposures to extreme events such as natural catastrophes, man-made disasters and other non-natural perils. While such events occur rarely, their financial impact on an insurer can be significant and can result in insolvency.

2 The insurance concentration risk component is calculated as the insurer's maximum event retention (after taking into account acceptable reinsurance recoveries) plus the cost of 1 reinstatement of those reinsurance arrangements if the reinstatement reinsurance cover has not been pre-paid by the insurer.

3. Specialist insurers, such as providers of medical indemnity, may not necessarily be exposed to large losses due to the aggregation of claims linked to a single catastrophe-type event like a pandemic. However, these insurers may still be exposed to insurance concentration risks and large losses arising

from groups of claims relating to a common dependent source. For example, a medical insurer covering thousands of lives through a company scheme may face a large number of claims arising from employees' class action relating to a faulty medical procedure.

A3.10.2 *Insurance concentration risk component*

(1) The ***insurance concentration risk component*** for an insurer that is protected by catastrophe reinsurance cover is:

$$MER + CoR\ (if\ any) - RP\ (if\ any)$$

where:

MER has the meaning given in rule A3.10.3.

CoR or ***cost of reinstatement***, in relation to an extreme event, means:

(a) the rate that an insurer has, under contract, agreed to pay the reinsurer concerned to reinstate the reinsurance cover relating to the extreme event; or

(b) if the insurer has not agreed on the rate for the reinsurance cover—the insurer's estimate of the cost of reinstating that cover based on current reinsurance market conditions (but no less than the original rate of reinsurance cover).

RP or ***reinstatement premiums***, for an insurer that also writes reinsurance, means the amount of inward reinstatement premiums from cedants in respect of catastrophe reinsurance cover if the insurer has a binding netting arrangement with the cedant.

(2) The ***insurance concentration risk component*** for an insurer that is not protected by catastrophe reinsurance cover is:

$$2 \times LPR$$

where:

LPR or ***largest per-risk retention*** means the largest claim payout that the insurer may reasonably be exposed to under the policies issued by it, net of reinsurance recoveries, but including the cost (if any) of reinstating the reinsurance cover.

(3) An insurer that is not protected by catastrophe reinsurance cover must seek advice from its approved actuary about estimating its

largest per-risk retention if the insurer issues policies that do not have a maximum amount insured.

A3.10.3 *Maximum event retention*

(1) ***MER*** or ***maximum event retention***, in relation to an extreme event, is the maximum amount of loss to which the insurer will be exposed due to an accumulation of exposures, after netting out any potential reinsurance recoveries.

Guidance

An insurer should at a minimum calculate an MER that relates to an accumulation of exposures to a single extreme event. However, the Regulatory Authority may require an insurer with a complex portfolio of insurance risks to use a whole-of-portfolio estimation approach.

(2) In calculating its MER, an insurer must:

(a) set the amount based on the accumulation of exposures of the insurer to a single extreme event;

(b) assume a return period of 1 in 250 years (or greater), where the return period is the expected average period within which the extreme event will re-occur; and

(c) take into account:

(i) its risk profile and risk tolerance;

(ii) its claims history (using available internal and external data);

(iii) the capital resources available to it;

(iv) its current and future solvency needs;

(v) its reinsurance programme;

(vi) the classes of insurance business underwritten by it; and

(vii) the areas where it conducts business.

(3) If an insurer is exposed to more than 1 extreme event, its MER is the largest of the MERs calculated by the insurer for those events.

(4) Despite anything in this rule, the Regulatory Authority may require the insurer to make adjustments in calculating its MER.

Explanatory note

This amendment:

- simplifies the calculation of premium risk component, technical provision risk component and long-term insurance risk component
- sets out the definition of capital at risk for the purposes of calculating long-term insurance risk component
- introduces a new insurance concentration risk component and maximum event retention for insurers.

[1.27] Glossary, definition of *base capital requirement*

omit

Explanatory note

This amendment omits a term that is no longer needed now that there is a single amount of US $10 million for the requirement.

[1.28] Glossary, definition of *risk management strategy*

substitute

risk management strategy, of an insurer, means the document described in part 2.2 and CTRL, rule 4.1.4.

Explanatory note

This amendment updates the definition to take into account changes in CTRL.

[1.29] Glossary

insert the following definitions

asset risk component has the meaning given in rule A3.2.1.

authorisation means an authorisation granted under FSR, part 5.

authorised firm (or ***firm***) means a person that has been granted an authorisation in accordance with FSR, part 5.

counterparty means a person with whom an insurer conducts, or intends to conduct, insurance or associated business.

equity investment includes:

(a) an equity share;

(b) participation in a *collective investment scheme* (whether or not the underlying investments are themselves equity investments);

(c) participation in a joint venture; and

(d) a certificate of Mudaraba or Musharaka.

extreme event means an unusual high-impact or catastrophic event the occurrence of which could have a significant effect on an insurer's solvency.

firm (or ***authorised firm***) means a person that has been granted an authorisation in accordance with FSR, part 5.

FSR means the *Financial Services Regulations*.

group risk has the meaning given in schedule 1, guidance S8.1.

insurance concentration risk component, in relation to an insurer, has the meaning given in rule A3.10.2.

insurance liabilities, of an insurer, means liabilities of the insurer arising out of its general insurance business and long-term insurance business.

insurance risk requirement has the meaning given in rule 3.6.1.

internal model, for an insurer, means the model approved by the Regulatory Authority for calculating all or part of the insurer's risk-based capital requirement.

Note An approved internal model may be used to replace specified components of the operational, investment and insurance risk requirements of an insurer (see r 3.8.1 (b)).

investment-linked insurance means insurance where the benefits under a contract of insurance are wholly or partly determined by reference to:

(a) the value of, or the income from, property of any description (whether or not specified in the contracts); or

(b) fluctuations in, or in an index of, the value of property of any description (whether or not so specified).

investment risk requirement has the meaning given in rule 3.5.1.

long-term insurance risk component has the meaning given in rule A3.9.2.

MCR means minimum capital requirement.

minimum capital requirement (MCR) has the meaning given in rule 3.3.1.

policy benefit means an amount payable under a contract of insurance as a result of the occurrence of an event insured against under the contract.

premium liability has the meaning given in rule 8.6.7.

QFC captive insurer means an authorised firm that has an authorisation for captive insurance business under *CAPI*.

relevant scheme has the meaning given in FSR, article 94 (4).

risk-based capital requirement has the meaning give in rule 3.4.1.

scheme report means the report that, under FSR, art 97, must accompany a relevant scheme.

senior management, of an insurer, has the meaning given in CTRL, rule 2.3.1.

Explanatory note

This amendment inserts definitions that apply to these rules.

Part 1.2 Minor amendments

[1.30] Further amendments—italics and capitalisation

item	provision	*omit*	*insert*
1	all	*authorisation*	authorisation
2	all	*authorised firm*	authorised firm
3	all	*captive insurer*	captive insurer
4	r 5.1.1	*captive insurers*	captive insurers
5	r 6.6.2	*Categories*	categories
6	Appendix 2 guidance 5. b.	*Counterparties*	counterparties
7	all	*FSR*	FSR
8	all	*insurance liabilities*	insurance liabilities
9	r A3.2.3 (2)	*Insurance Liabilities*	insurance liabilities
10	all	*Internal Model*	internal model
11	all	*Minimum Capital Requirement*	minimum capital requirement
12	all	*Policy Benefits*	policy benefits
13	r 8.6.7	*Premium Liability*	premium liability

14	all	*Relevant Scheme*	relevant scheme
15	r 11.1.2	*relevant scheme*	relevant scheme
16	all	*Risk Based Capital Requirement*	risk-based capital requirement
17	all	*Scheme Report*	scheme report

Explanatory note

This amendment removes unnecessary italics and capitalisation.

Schedule 2 Amendments of the Interpretation and Application Rules 2005 (INAP)

(see r 3)

[2.1] Glossary

omit the following definitions

Insurance Liabilities

Insurance Risk Requirement

Internal Model

Invested Asset

Investment Linked Insurance

Investment Risk Requirement

Minimum Capital Requirement

Policy Benefit

Premium Liability

Risk Based Capital Requirement

Relevant Scheme

Scheme Report

Explanatory note

This amendment removes the definitions of terms that are used only in PINS.