



United Nations Conference on Trade and Development
International Association of Insurance Supervisors



SUPERVISION OF INSURANCE OPERATIONS

**AN INTRODUCTORY TRAINING MANUAL FOR STAFF OF
INSURANCE SUPERVISORY AUTHORITIES**

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This new second edition of the manual was directed by Steve Butterworth of the Guernsey Financial Services Commission, who was the original Chair of the IAIS Education Subcommittee, and incorporates the IAIS Core Principles of Insurance Supervision. Also included are many suggestions and improvements received from the OECD, Financial Stability Forum, World Bank, International Monetary Fund, UNCTAD Secretariat and the Insurance Regulatory Authorities of IAIS member jurisdictions.

In this new second edition the initial draft of the manual has been revised to include comments received from many insurance supervisors from all over the world. In particular, members of the Education Committee of the IAIS have greatly contributed to bring the manual into its present final form and thanks are also given to Standard & Poors, John Gardener and Harold Russell. Considerable assistance was given by The Guernsey Financial Services Commission (especially Nina Degnen), Nigel Easton of the UNCTAD secretariat, Robert Gibbons and Ian Gibbs of The International Insurance Foundation in Washington DC, Malta, Don Mclsaac of the World Bank, and financial services journalist Bob Baker.

Lawrie Savage & Associates Inc, a Canadian firm that advise on insurance and supervisory issues and are observer members of the IAIS, prepared the text of 'The Supervisory Ladder and Risk Based Supervision' to be found in the introduction to Module 3.

SUPERVISION OF INSURANCE OPERATIONS

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FOREWORD

1. The production of the first edition of this manual was directed by the Education Committee of the International Association of Insurance Supervisors (IAIS) in conjunction with the Insurance Programme of the United Nations Conference on Trade and Development

2. The manual was originally prepared to help respond to the need of many supervisory authorities particularly in developing countries (including those that are to introduce or recently have introduced reforms towards establishing insurance markets based on market economy principles), for training material to expand the understanding and knowledge of their personnel on “why” and to some extent on “how” to supervise insurance operations. The present document should be used as an introduction for newcomer staff to their professional duties and responsibilities while providing them with a broad background to better comprehend the role of the insurance supervisory authority. It can also be used by new senior staff who have not been previously involved in insurance supervision. It will give them a broad understanding of the subject matter and a comprehensive understanding of the Core Principles of Supervision used by the International Association of Insurance Supervisors (IAIS).

3. The manual was devised as a flexible tool to permit any supervisory authority to include material relevant to their own legal, economic or social environment. Therefore, a version on computer diskette is also available.

4. The IAIS Core Principles of Supervision (the Core Principles) can be used as the basis of supervision in any jurisdiction.

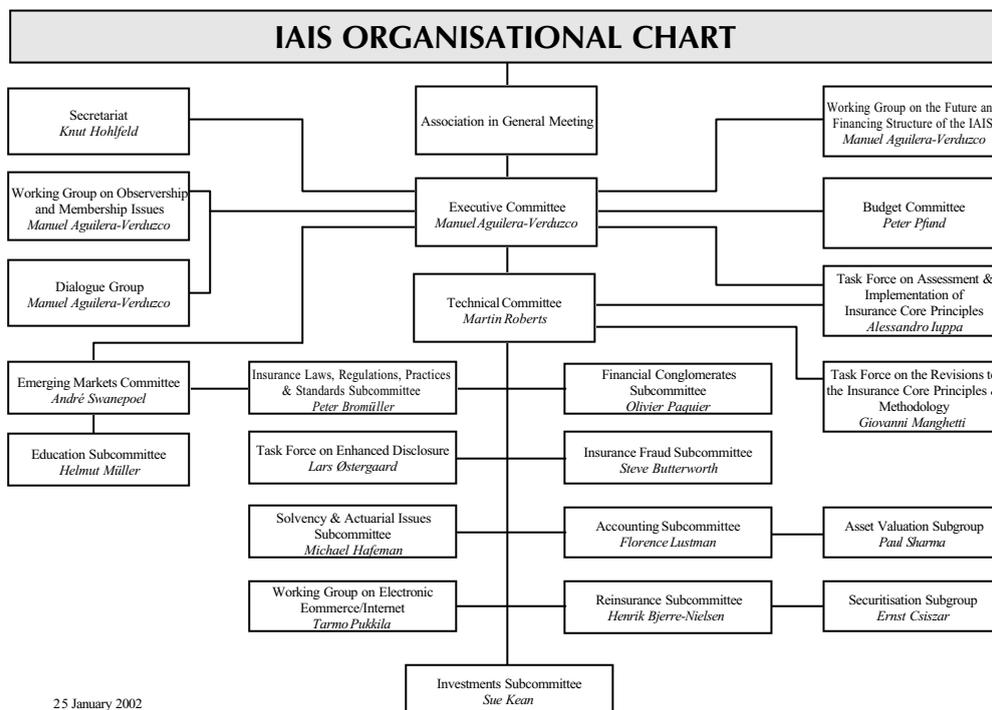
5. As long as the core principles are adhered to, insurance regulation and supervision in a jurisdiction should be tailored to local conditions, political and management cultures and outlooks prevailing in that jurisdiction. Also, regulatory and supervisory frameworks must be adapted constantly to match changing conditions, perceptions and economic needs. They also need to be fine tuned and improved on the basis of accumulated experience. The relevant IAIS Insurance Core Principle has been inserted in the relevant position in this manual. The IAIS has also brought out a methodology which explains the criteria to be used in order to ensure that the Core Principles are all covered. These criteria are divided into those that are essential and those considered to be additional and therefore applicable to jurisdictions with more advanced systems of supervision. The criteria are also contained within the relevant part of the text. It should be remembered that the IAIS Insurance Core Principles have been adopted by the general membership and are not mandatory but are considered by IAIS to be best practice.

1. International Association of Insurance Supervisors

The International Association of Insurance Supervisors (IAIS) is the primary global organization for international insurance regulators with a membership of over 100 jurisdictions. Established in June 1994, the IAIS recognizes that insurance industries and markets are of fundamental economic importance, nationally and internationally and that most domestic insurance markets are increasingly being integrated into a global market.

Recognizing these factors, the IAIS established an independent forum for meetings of insurance supervisors for their mutual benefit, to engender awareness of common interests, to encourage wide international co-operation, to better protect insurance policyholders and to promote and secure efficient insurance markets.

Besides promoting exchange of information and co-operation between supervisors, the IAIS's mission is to establish international standards on insurance supervision and to conduct training seminars for insurance supervisors from emerging markets.



The IAIS has an Executive Committee which oversees the work of the different committees, subcommittees, and other working parties. The Technical Committee and its subcommittees develop international principles and standards on insurance supervision. The Emerging Markets Committee deals with issues related to emerging market economies. Supported by the Education Subcommittee it particularly prepares and organizes or co-organizes regional training seminars for insurance supervisors to help countries implement the supervisory principles.

The IAIS is always developing textbooks and case study material on insurance supervision and regulation for insurance supervisors. These serve as training material for effective supervision of insurance companies on a daily basis as well as providing guidance for development of insurance legislation.

In order to assist emerging market insurance systems, the IAIS has prepared a list of IAIS insurance experts who can contribute to training insurance supervisors.

The Association further coordinates its efforts with other financial regulators, particularly those from the banking and securities industries. Thus, the IAIS, in collaboration with

Basel Committee and IOSCO, organizes the Joint Forum in order to deal with issues of common interest to the three organisations.

Furthermore, the IAIS is a member of the Financial Stability Forum, which was created by the G7 Finance Ministers and Central Bank Governors in 1999 in order to improve co-ordination and information exchange among the national and international authorities responsible for financial stability issues. Its aim is to identify vulnerabilities in the international financial architecture and to ensure that they are addressed through timely and coordinated preventative action.

In 1999 the IAIS decided to open a new membership category called 'observer'. Observership is open to all those who are not regulators but who are interested in contributing to the work of the IAIS. In particular this includes associations of insurers, insurance companies and other organization and entities related to insurance. Observers have the right to participate in the final consultation process for IAIS insurance principles and standards papers, its textbooks and can comment on these while in draft form.

The IAIS Secretariat office is located in Basel at the Bank for International Settlements. For more information please contact the following address.

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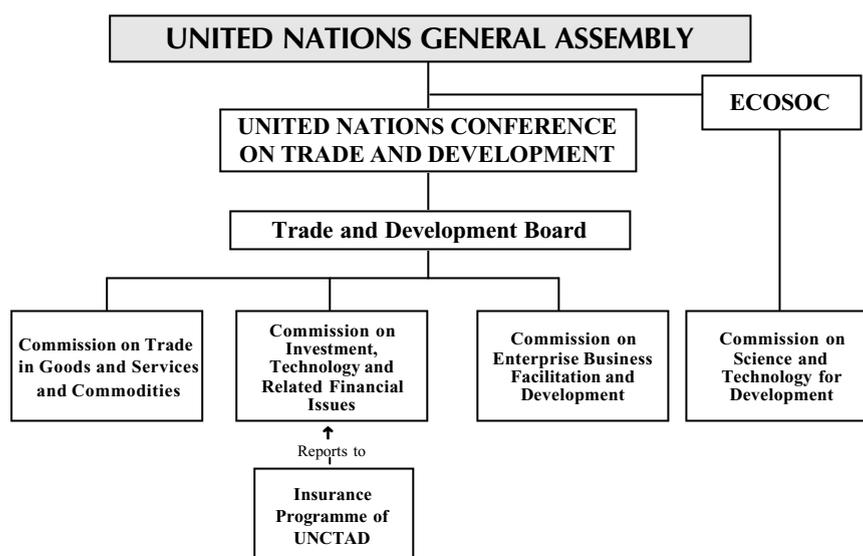
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2. The United Nations Conference on Trade and Development

The United Nations Conference on Trade and Development (UNCTAD) was established in 1964 to affirm the conviction of the United Nations General Assembly that international cooperation in trade and development is vital for world economic growth and the economic development of developing countries. With a membership of 191 States, UNCTAD is a permanent intergovernmental body and an organ of the General Assembly. Its aim is the development-friendly integration of developing countries into the world economy

Within the United Nations family of organizations, UNCTAD is the only one which has insurance consistently included in its mandate and its regular programme of work. The current mandate from the UNCTAD Conference which met in February 2000 in Bangkok is contained in the 2000-2004 UNCTAD Plan of Action as agreed by the Conference, which says "UNCTAD should carry out analytical and technical assistance work to help regulators and relevant insurance industry associations in upgrading the regulatory and institutional framework for this sector to adapt to international and best practice and to requirements under WTO/GATS".

Through the implementation of this mandate, the Insurance Programme of UNCTAD works to try and assist developing countries to create the necessary enabling environment for the provision of commercial insurance cover to meet the needs of the local economy and insurance which is necessary for business transactions with the rest of the world.



In terms of the intergovernmental structure of UNCTAD, work in the field of insurance is guided by the Commission on Investment, Technology and Related Financial Issues and ultimately by the Trade and Development Board and the Conference itself. The Insurance Programme undertakes studies on insurance matters relevant to developing countries and economies in transition and provides technical assistance through technical cooperation activities and projects and participates in and organizes training and human resources development activities. It provides support for building legal and regulatory frameworks as well as promoting the development of domestic and regional insurance sectors. It also promotes inter-regional, regional and sub-regional cooperation on insurance issues. Particularly relevant in the context of this manual, the Insurance Programme of UNCTAD has conducted and is conducting training activities for the personnel of insurance supervisory authorities. Currently, such training sessions are conducted for the benefit of African, Asian, Indian Ocean and Caribbean countries.

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3. The College of Insurance, New York

The College of Insurance, located in the financial district of New York City, has been a fully accredited College since 1962. Throughout its history, its core mission has been to advance the understanding of insurance and the education of insurance professionals. Today, the College of Insurance, an internationally recognized private college, continues to pursue that mission for the benefit of as broad a constituency as possible. The College's ten-story, self-contained campus includes four floors of residence halls, classroom and conference space and the Kathryn and Shelby Cullom Davis Library, which houses one of the largest and most comprehensive insurance collections in the world. The College of Insurance offers bachelor degrees in Business Administration, Finance, Insurance and Actuarial Science and MBA's in Finance, Insurance, Risk Management and Actuarial Science.

A Center for International Insurance Studies at the College of Insurance was established in recognition of the need for a central institute devoted to the exchange of information and research between the insurance sector in the United States and similar sectors around the world. The Center has provided training for foreign supervisors through placements in government and industry through programmes individually designed to meet the specific needs of the participants. These programmes, which last from several days to several weeks, can be held at the College or in the participant's home country.

The Center also undertakes research projects on all aspects of insurance. These range from structuring an insurance supervisory model for a developing country, to drafting statutes or recommendations for governments seeking to implement changes or to gain new perspectives on existing problems.

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GENERAL SUPERVISION

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A.1 INTRODUCTION

In establishing and developing a regulatory system to best suit a given culture, government and economy, it is useful to look first at the role of insurance in today's world and the role the insurance business and the insurance industry will play in a jurisdiction's development. Insurance is necessary to protect the people, goods and services of a growing free economy. It is also a vital part of the entire financial process. Negative events in the insurance sector will affect an entire economy. Each jurisdiction must take into consideration the best shape and direction for their market. Once this analysis is complete, it will be easier to determine the regulation which will best enable a jurisdiction to achieve its specific goals. In defining such regulation, and developing appropriate insurance legislation, it is important to remember that it must be consistent with existing contract law and other relevant statutes.

A.1.1 Development of insurance

The business of insurance began with the insurance of cargoes shipped or otherwise transported great distances. This insurance consisted of private transactions, supervision was only a reflection of the requirements of commerce. However, as far back as the 15th and 16th centuries the establishment began specific rules for the business of insurance in major European jurisdictions. Now insurance has grown to encompass almost all business and personal needs and is seen as the 'great protector'. It is also extensively supervised throughout the world.

Insurance is a means by which risk is spread among all members of a given group. Apart from that basic similarity, the business of life insurance and that of non-life insurance are based on very different premises and considerations. Life insurance generally covers two classes: small groups and individuals and large groups. Non-life covers insurance of personal and real property, professional indemnity for individuals, motor insurance, and other products, most of which insure things rather than people. An insurance premium is based on the mathematical probability that a defined loss will occur. For example, if an individual insures his home against fire, he does not expect a fire to occur but wants to be protected if it does. Since most homes are not usually damaged or destroyed by fire most people who purchase such protection will pay premiums but will not collect proceeds. This, of course, provides surplus funds for insurance companies to use to pay those who do suffer damage. Regulation, among other things, tries to establish standards which assure that these premiums, and the income from investments made with them, will be sufficient to pay the probable claims calculated through actuarial studies. The same principle holds true with insurance for large commercial groups although it is recognized that these consumers are likely to be more sophisticated and need less protection through supervision. This has been accepted by many jurisdictions, including the European Union, in their drafting and structuring of insurance directives. In practice, what is used are the same principles which were used to insure ships' cargoes several centuries ago.

Life insurance (or life assurance as it is called in many jurisdictions) raises different issues. When an individual purchases life insurance he can be certain that he will die. If the policy will last him throughout his life, then it is absolutely certain that the benefit must be paid and premiums and investments must reflect this. If, however, a policy is purchased for a determined term of years, then some of the same considerations used

in pricing and investing the premiums of non-life policies will be applicable.

It is clear that the way in which an insurance industry operates within a jurisdiction depends, to a great extent, on the cultural and political needs of the people. For example, in a jurisdiction where property has only been owned by the state and where all parties will receive pensions or employment, the role for insurance is naturally diminished. In countries with strong entrepreneurial histories, insurance becomes a vital tool for protecting against unexpected loss and economic misfortune. The climate, exposure to natural disasters, structure of the laws of inheritance, system of extended family, social welfare systems and other intangibles will all affect not only the structure of the insurance industry, but also the need for and type of government regulation to be put in place to monitor that industry. In jurisdictions in the midst of significant changes in their economies and economic direction, insurance can serve as a means to protect the tools of that economy and to stabilize it. Insurance is a key part of any plan for economic development.

It has long been recognized that, because insurance provides a critical layer of protection, the industry must be supervised in order to try to guarantee the availability of the necessary funds when they are needed for payment of claims. The issues become even more critical when relating to the coverage of a person depending upon the insurance as a source of survival. From the start, insurance company solvency is the primary goal for insurance supervisors.

In this manual we will attempt to indicate the many areas in which insurance has been supervised and varying ways in which that supervision is undertaken. We recognize that supervision is not an abstract concept but rather one in which a supervisor must make decisions about what should be supervised as well as the methods to be used. A supervisor must also have the power to enforce those decisions. It is acknowledged that insurance supervision for a sophisticated consumer, in a market which has successfully operated over a long period, may not necessarily be a suitable model for an emerging market in a jurisdiction with little or no recent history of private insurance, or with a public which has no reason to have any faith in the industry or its products. Therefore, no attempt is made to provide fixed solutions. Instead, this manual hopes to highlight the options which are available so that jurisdictions can make decisions relevant to their needs yet still related to the experience of others. The ultimate supervisory choices will differ from jurisdiction to jurisdiction and market to market. The major common thread is that each supervisory structure has been put together to meet the goals of supervisors and parliaments. Thus, 'Why are you supervising?' becomes as important as 'How are you supervising?'

The IAIS Core Principles of Insurance Supervision, which reflect the consensus of the insurance regulatory authorities of member jurisdictions and countries, are an attempt to summarize the generally accepted goals for the regulation and supervision of the insurance industry. These Core Principles are dynamic and, at the time of publication of this manual, are being looked at to ascertain whether or not any revisions are necessary. In particular, there is a debate on the supervision of reinsurance and insurance intermediaries.

Since terminology differs from jurisdiction to jurisdiction, we have used titles and designations interchangeably. Although in some jurisdictions

the regulatory body is the body dealing with legislation and the supervisory body deals with monitoring insurance activities, in this manual, the terms insurance department, insurance supervisory authority, insurance regulatory body are given identical meanings. When the word insurance is not included it is to be assumed, unless another area is specifically mentioned. The top individual in each of these entities has been referred to as commissioner, chief, head or by a word of similar meaning with no intent to differentiate between them. (For more complex or country-specific terminology, the IAIS glossary has been added).

This manual is partly designed to deal with the issues facing developing markets. It is also intended to assist those who are newcomers to the supervision of insurance. While drawing attention to the Core Principles, it does not purport to espouse any single solution, except to embrace the IAIS Principles of Insurance Supervision; nor does it seek to export any particular method of supervision. Instead, it offers a variety of solutions whenever possible, so that a supervisory authority can best determine the regime most suitable for its own constituency. It recognizes that much of this must first be enacted as law before a commissioner can define supervision. It also recognizes that, unless otherwise stated, tax, contract, and other relevant general laws within a jurisdiction must be taken into consideration - either by applying them to insurers or by exempting insurers from them.

A.1.2 Reform of the insurance market

Today, insurance is an integral part of the financial systems of jurisdictions. In some jurisdictions, where there has been a continuing reform of insurance markets, the increasing costs of social welfare systems, the opening of economies to capitalism and a free market approach have led to a shifting of responsibility from the state to the individual. The private sector in these reforming markets (through expanded competition) has been developing to serve the needs of the individual to protect himself and his goods and business and the need of the state to reduce its expenses and direct responsibility. This recasting of the protection system leads to the need for regulation and legislation to protect consumers and maintain the solvency of new insurance providers.

When introducing reforms to establish insurance markets based on market economy principles, effective regulatory and supervisory systems focusing particularly on consumer protection should be in place.

Under a monopolistic, oligarchic or state controlled system, the state is involved at every level of insurance operations: it approves and mostly fixes rates, terms and conditions for all products offered, determines the type of products and the 'State Guarantee' serves as the final backing for security and solvency of insurance operations.

The liberalization process of insurance includes the establishment of markets functioning under competition rules, where no player should be allowed to acquire a dominant position or impose its own conditions on the rest of the market. Conditions for transparency of information are reinforced by legislation to allow buyers and sellers to make 'informed decisions' based on actual market conditions. In a liberalized insurance market, market forces determine changes in price fixing mechanisms and rates. The same applies to product design.

The changes in market structures brought about by privatization and the introduction of competition rules, allow the entrance of new domestic and, often, foreign participants into the market. Demonopolization of reinsurance operations also allows for new entrants into this market. More generally, when liberalizing the economy, the demand for insurance tends to increase as state-owned manufacturing or service industries are privatized. Such entities which were inclined to self-insure when they were under state ownership begin to seek cover from the insurance market when they privatise.

The introduction of market economy principles and liberalization changes the nature of state involvement in the monitoring of insurance operations. The role of the state leans towards establishing market conduct rules and towards implementing prudential regulation focusing, in particular, on solvency and consumer protection measures. The state may also have a role in facilitating the development of an insurance industry. It is not enough to produce rules and regulations; these must be enforced in any type of economy and be accompanied by active and efficient supervision. It is equally important that politicians properly resource insurance supervisory departments.

Reforms introduce market economies, liberalization and privatization are expected to promote entrepreneurial freedom, responsibility and accountability, optimize allocation of resources, increase productivity and efficiency. They also bring a better match between supply and demand and ultimately better quality services at lower prices. More specific to insurance, the entry of new participants into the market, whether domestic or foreign (the latter by way of establishment or through cross-border activities) could more effectively encourage the mutualization and risk spreading process which, together, constitute the basis of insurance. New entrants to the insurance market could also lead to increased capacities to underwrite local risk.

However, in a liberalized environment, competitive pressure may induce some insurers to turn to unsound practices (uneconomic pricing, cash flow underwriting...) in order to retain market share. Under such conditions, insolvencies are more likely to happen. Thus greater consideration may need to be given to insurance consumer protection measures.

The new measures include prudential regulatory requirements such as increased standards for capital and solvency, prudent investment and reserving rules. However, regulation should not seek to reduce the probability of failure to zero. In order to produce such a condition, capital and other requirements would have to be so severe as to make the prospect of entering the insurance business an unattractive option for an investor. To monitor compliance with set rules, the establishment of an effective information system based on clear accounting and reporting rules is of prime importance. Improvement in market transparency and information (prior to inception of a contract of insurance and during its continuance) for consumers is essential. To check information that may exist under insurance contracts, close monitoring of policy wording is useful. Consumer education and the appointment of officers whose duties are to respond to complaints, also contribute to protecting insurance consumers. To shield consumers from the consequences of the insolvencies, the establishment of guarantee funds may be considered. With a liberalized environment and concomitant lowering of

product control, monitoring of intermediaries (agents, brokers) also becomes increasingly important. Opening up to foreign participation in domestic markets, both at the direct level or through reinsurance, poses questions for consumer protection, especially in relation to participation and security assessment structures.

The liberalization of an insurance market should never be considered as complete. A learning process is involved both at industry and supervisory levels. Before attaining the stage of a mature market, a transition period is necessary during which the elements for establishing a competitive market come into place, piece by piece. Mature markets are themselves subject to a continual process of evolution.

A first step towards a fully liberalized market could be to establish by law rules for the functioning of the insurance market, especially prudential regulations regarding capital, solvency, investment and reserving requirements, in addition to rules relating to insurance contracts and consumer information. The legislation could also specify the roles and powers of a supervisory authority giving it a degree of independence. A differentiation in the regulation of non-life and long-term insurance operations is also usually set by law.

During the first phase of a transition, rules, especially those relating to solvency requirements, should be clear and simple. They could be simplified versions of those adopted by developed countries and adapted to the local context. Capital requirements need to be set high enough, commensurate with the level of activity (this for example, depends on the classes of business underwritten and whether the business to be written is direct or reinsurance), in order to avoid fragmentation of the market and entry of unsound operators. Accounting standards and reporting requirements should be designed to allow effective supervision of the sector. Foreign entrants and forms of participation at this stage are a matter for policy decision. Capital and expertise could, however, be acquired from such sources, but the financial stability of foreign participants should be a concern. As an industry matures and consumers' understanding of insurance improves, further liberalization and regulatory reforms can be introduced.

This next section of the introduction is for those jurisdictions that are moving or considering moving from a state controlled market to one controlled by the market economy.

Understandably, a number of new markets are emerging in jurisdictions where there has been no history of private (or even public) insurance. The way these markets previously traded often resulted in little need for the insurance of goods or plants. Much, if not all the security afforded by private insurance was offered by the state, and not always very successfully. Consumers had no reason to purchase insurance and were probably, and understandably, somewhat suspicious of the need. The lack of knowledge and experience among consumers, along with the initial receipt of premiums providing insurers with available cash, well before claim payments begin, can create opportunities for abuse and excessive risk. However, before this is interpreted to support a need for strict and rigid regulation, we must also consider how to be creative and to encourage opportunity for new entrants into the market. Somehow, evolving statutes must strengthen consumer confidence and knowledge while, at the same time, provide opportunities for both experienced and newly organized insurers to compete and expand the marketplace. To

complicate matters further, few of the relevant jurisdictions can, at this time, afford a costly system of supervision. Therefore, supervisory requirements that have some flexibility for changing circumstances as the industry matures must be consistent. On the other hand, extremely broad statutes, leaving too much discretion to regulators, can cause great uncertainty for potential investors and could limit the growth of the industry.

A.2 SUPERVISORY STRUCTURE

The first key decisions are made by governments and relate to the positioning of the office of supervision within that government and to establishing the extent of its independence, autonomy and resources. Additional key questions relate to the terms of entry and exit of insurers along with the sanctions which the supervisor or the government can take against miscreant insurers.

The IAIS Core Principles, Essential and Additional Criteria are shown in the following box.

A.2.1 Organization of an insurance supervisor (IAIS Core Principle 1)

The insurance supervisor of a jurisdiction must be organised so that its able to accomplish its primary task, i.e. to maintain efficient, fair, safe and stable insurance markets for the benefit and protection of policyholders. It should, at any time, be able to carry out this task efficiently in accordance with the Insurance Core Principles. In particular, the supervisory authority should:

- be operationally independent and accountable in the exercising of its functions and powers;
- have adequate powers, legal protection and financial resources to perform its functions and exercise its powers;
- adopt a clear, transparent and consistent regulatory and supervisory process;
- clearly define the responsibility for decision making; and
- hire, train and maintain sufficient staff with high professional standards who follow the appropriate standards of confidentiality.

Essential Criteria

1. The responsibilities of the insurance supervisor are clear and objectively stated.
2. The insurance supervisor is operationally independent from both political authorities and the insurance companies that it supervises in the execution of its supervisory tasks and is accountable in the exercise of its functions and powers.
3. The insurance supervisor has adequate powers, legal protection and proper resources and staff, and the capacity to perform its functions and exercise its powers.
4. The insurance supervisor adopts clear, transparent and consistent regulatory and supervisory processes. The rules and procedures of the insurance supervisor are published and updated regularly.
5. The decision-making lines of the insurance supervisor are structured so that action can be taken immediately in the case of an emergency situation.

Continued

Essential Criteria Continued . . .

6. The staff of the insurance supervisor observes the highest professional standards including appropriate standards of confidentiality.
7. The insurance supervisor establishes an employment system to hire, train and maintain the staff with the highest professional standards.
8. Remuneration paid by the insurance supervisor is such that it is able to employ and keep highly qualified staff.
9. The insurance supervisor is able to use its funds flexibly so that it can react flexibly and quickly. Necessary activities (eg international cooperation) and actions (eg on-site inspections) should not fail for budgetary reasons.
10. If its own capacities are not sufficient, the insurance supervisor should be able to outsource to third parties (eg auditors, actuaries) supervisory tasks such as on-site inspections and monitoring the solvency position or the sufficiency of technical provisions (policy liabilities). Where functions are outsourced to third parties, the insurance supervisor is able to:
 - Assess the competence;
 - Monitor the performance (for instance, through reviewing working papers); and
 - Ensure the independence from the company and the consideration they give to the protection of the policyholders' interests.
11. Third parties are subject to the same legal requirements, in particular concerning confidentiality, as the insurance supervisor. If required, the insurance supervisor must have the ability to take actions against these third parties either directly or through the appropriate professional body.

Additional Criteria

1. Rules are in place for the dealings between the members of the supervisory staff and the insurance companies (eg as regards the acceptance of gifts or invitations).
2. Regulatory staff are subject to conflict or interest rules (eg prohibition on dealing in shares or investments in the companies that they regulate).

The following types of structure are to be found in jurisdictions around the world:

A.2.2 Free-standing

A free standing, independent authority has a position of authority and strength in terms of controlling its insurers. Its staff are divorced from politics and can give continuity to the regulatory process. Because it is free standing it will probably need to have separate offices and employ 'peripheral' staff such as receptionists, accountants, caretakers etc which add to the cost of supervision. This system also calls for acceptable expertise on the part of the head supervisory personnel. It does create an opportunity to focus on insurance and minimizes the need for 'trade-offs' within a department.

A.2.3 Quasi-independent

Sometimes politics or economics do not permit a totally free-standing body, as recommended by the IAIS. A compromise could be similar to the old British solution where, for many years, the insurance regulatory authority was a virtually independent body within the Department of Trade and Industry. Although it functioned with a great degree of independence, its political connection was through the Minister of Trade. This worked particularly well in the United Kingdom, because the head of the Insurance Department, as well as the staff, were all civil servants and, therefore, less prone to political influences and change. Recently the UK has set up a new regulatory body for all financial services, including insurance. It is the Financial Services Authority.

A.2.4 Integrated section or department

In some countries, the insurance department is a division of a supervisory authority that might regulate all financial services providers including banks, insurers, security firms and fiduciaries, or a combination of these.

The lowest level of independence is that in which a supervisory authority is only one part of a jurisdiction's Ministry of Finance or other appropriate body and the insurance supervisor must rely on the actions of the Minister of Finance. However, the independence of the department can also vary in these circumstances. Such variance usually would be related to the experience and expertise of the insurance supervisor and his immediate deputies.

Regardless of the chosen format, a supervisor must be able to make decisions promptly while still being accountable for those decisions. The statutes of the jurisdiction must enable him to carry out the obligations of his position and the general environment must not hamper his need to act fairly.

A.3 COMPANY OPERATIONS AND MANAGEMENT

A.3.1 Emphasis on company operations

It is generally agreed that the monitoring of the business and finances of supervised companies on a close, regular and frequent basis to assure their continued solvency, is the primary role of an insurance supervisor. Any problems which might affect financial stability should be dealt with promptly. However, monitoring in some jurisdictions requires pre-approval for policies, marketing methods and sales literature, and, sometimes, rate or premium changes. Any actions which could indicate a change of company policy or direction are subject to question by the supervisor and sometimes prior approval is required. In these countries, controls on the selection of managers or controlling persons are usually less emphasized. Frequently, as long as senior managers have no criminal record - particularly for embezzlement or other white collar crimes - an insurance supervisor remains detached. Changes in management personnel do not require prior approval. The underlying principle is that the staffing of a company and its selection of management is an internal matter not to be interfered with by a supervisory authority.

The critics of this method of supervision consider that it may create an adversarial relationship between the supervisor and the supervised. They believe there is often suspicion and mistrust with both sides tending to perceive the supervisor as a protector of the consumer against the insurer. However, less emphasis on management approval can create greater autonomy for insurers in running their businesses and uphold the right of individuals or groups, with sufficient capital, and a legitimate business plan, to start an insurance company. It may also create unnecessary friction but this can usually be ameliorated after the parties become more comfortable with each other.

In the IAIS Core Principles there is no mention of pre-approval for policies, marketing methods, sales literature and rate changes, but Principles 4 and 5 emphasize the need for good corporate governance and internal control. This does not mean that the pre-approval process is wrong; only that the members of IAIS could not reach a consensus on the matter. Indeed, the USA which places heavy emphasis on consumer protection, are strong proponents of rating approval and, even some European jurisdictions who accept the EU Insurance Directives, believe that some form of rate control is essential. Other jurisdictions and some international trade organisations such as WTO believe that prices and product structures are matters to be determined by market competition. Regulators should intervene only when there is doubt about the financial security of the market or the insurer.

A.3.2 Emphasis on management

Some jurisdictions use the 'fit and proper' standard as an integral part of their emphasis on prior approval of management shareholders and other controlling persons. They scrutinize credentials and demand predetermined levels of experience, qualifications and education. Prior approval is also required for any changes in management. Some countries require employees with particular qualifications to be part of a management team. For example, the United Kingdom insists that every life company has an appointed actuary with two legal responsibilities - one is to the supervisor and the other to the company. The standard for 'fit and proper' management focuses on the honesty, integrity, competency and financial experience of directors and officers or any individual assuming a controlling position within a company. The aim is to have a more co-operative and less adversarial relationship between the supervised and supervisors. Because managers realize supervisors can judge their fitness at any time, then tend to exercise a great degree of responsibility and co-operation. To further guarantee adequate management, from a business and technical perspective, certain positions can be mandated before licenses are granted. For example, life companies in the UK are required to appoint an actuary, those in the USA must have a medical director, other jurisdictions require the appointment of a general representative, legally responsible to the supervisor for compliance with legislation.

Both methods have advantages and disadvantages. In an emerging market, general co-operation would be advantageous as would control over management by a supervisor. In countries where the private insurance industry is new, it is important that company management understands the parameters under which it must operate. Therefore, a combination of the two methods might be appropriate.

A.4 FUNDING

The decision on the type of funding of a supervisory department is related to the supervisory structure discussed in the last chapter. IAIS members prefer a totally independent body and it follows, therefore, that self-funding is the preferred option. However, this route may not be feasible in some jurisdictions. Whatever method is used, it is important that governments recognize the importance of insurance supervision and do not adversely influence prudential measures used by a competent insurance supervisor.

A.4.1 Self-funding

This creates the greatest autonomy for a supervisory authority. In some jurisdictions there is no need for funds or budgets to be approved by another government department but most finances of self-funded agencies are, quite properly, subject to public scrutiny. Jurisdictions which adopt this type of funding generally rely on 'fees for service' plus, sometimes, taxes on insurers to raise sufficient reserves. Licensing fees, examination fees, and fines levied on the industry all contribute to these revenues. In the USA, where insurers are generally taxed on premiums, rather than income, part or all of such tax revenues become part of the income of self-funded insurance departments. This system is best suited to jurisdictions which can be assured a steady stream of income from the sources mentioned. It would not be viable in a fledgling industry with minimal resources. It is also unlikely to be useful in a jurisdiction which relies on revenues collected by its insurance authority to help fund other government functions.

A.4.2 Set budget allotment

This offers a 'middle of the road' alternative. Set budget allotment requires approval and/or concurrence by the responsible authorities. This might also include a specific review of line-by-line expenses and revenues. However, once money is allocated, a supervisor should not need to seek additional approval for actual expenditures. Funding mechanisms for such budgets vary, and some require that money is spent only in the manner for which it was originally allocated. Others permit the transfer of funds between budget items to provide flexibility. This option should serve the needs of most head supervisors when anticipated expenses can be predicted with some degree of accuracy. A disadvantage is that the insurance supervisory authority has no incentive to generate revenue through fees or other charges.

A.4.3 Part of general budget

Under this formula, although a general budget is drawn up, money is actually dispersed by the oversight authority on a modified, 'as needed' basis. Items such as salaries, rent and other fixed charges can be projected with accuracy on a yearly basis. Other items such as supplies, travel, research etc. are funded as requested. This type of funding gives an insurance supervisor the least management control over the department. It gives a state, or body which controls the insurance budget, great authority over routine activities. It does, however, enable an insurance department to operate normally, even if its expenses exceed projections.

There are ways of combining these options. For example, specific revenues of the insurance supervisory authority (i.e. examination fees) can be allocated to corresponding areas of expenses (i.e. travel and salary for examiners). Some jurisdictions calculate fees to equate with expenses for given activities. Other schemes mandate that spending above pre-designated thresholds require prior approval. The basic rule for establishing an initial funding mechanism is to determine the most likely source of funds and the accuracy of projected expenses. As the industry, and a supervisory authority, grow the mechanism can be changed.

A.5 SELECTING THE SUPERVISORY HEAD

The method used to select the head of an insurance supervisory authority depends, to a great extent, on the form of government of the jurisdiction. It also depends on the culture of the jurisdiction-i.e. to what degree the civil service is used, the power of the elected government, the degree to which bureaucracy needs to be revamped, etc. States in transition from a totalitarian bureaucratic form of leadership may not have an experienced civil service which can cope with the complexity of privatizing and expanding an insurance market. It is not unheard of to fill the position of insurance supervisor with an 'expatriate', 'repatriate' or a foreign insurance expert with experience in the industry and knowledge of the jurisdiction and its culture.

A.5.1 Direct election

In some jurisdictions heads are elected by public franchise. This works best in small jurisdictions with well established systems of popular voting. It does not work as well in parliamentary systems where control is based on party affiliation and majority blocs.

A.5.2 Appointment for a fixed term

Fixed term appointments occur in jurisdictions which view their chief insurance supervisor as a civil servant, not bound by party ties or political considerations. Individuals are generally rotated through different supervisory positions and need not depend on the favour of the party, or parties in power. This method provides a great degree of autonomy for a supervisor since there is no constituency to serve. A supervisor need only be concerned with enforcing statutes and ensuring the viability of the industry. This method is usually preferred by many international agencies because the supervisor is independent from all influences - political as well as economic. The preferred situation is to have an appointment that is not subject to premature termination except for disability or gross misconduct, and with criteria stipulating grounds for dismissal.

A.5.3 Political appointment

Commissioners or heads can be appointed by a ranking member of a political party or bloc in power. This could be a Prime Minister or, more usually, a Minister of Finance. A head serves at the discretion of the appointing minister with no specific term. When a minister is ousted, there is nearly always a new appointment. Although this can provide opportunities for special interests to influence a head's decision, they can be avoided if appointed individuals are strong, impartial protectors of the financial solvency of insurers and the needs of policyholders.

A.6. REPORTING AND ACCOUNTABILITY BY THE SUPERVISORY AUTHORITY

There are two types of reports to be expected from an insurance supervisor. One type keeps government officials abreast of trends in the industry, of emerging problems and of progress with regulatory and supervisory reforms. The second type is for public consumption and is the source whereby consumers can obtain information about insurers operating in a jurisdiction. The internet is now frequently used to provide such information. Reports for consumers are dealt with in the next chapter.

There is no clear-cut answer when considering a best method of oversight because this is an integral part of the governmental process. The ultimate choice depends upon how an insurance authority is positioned within the government, its degree of autonomy in general and the levels of trust among different arms of the central government.

There should be a presumption that an insurance supervisor is accountable for action taken and the effectiveness of the supervisory system - even those with independent and fixed-term appointments. The insurance supervisor is usually directly or indirectly controlled by the legislation of Parliament who would have the right to summon the supervisor to give an account of his stewardship.

A.6.1 Annual report

Annual reports provide the greatest freedom for supervisory authorities and are generally confined to reporting information. Such reports are usually printed and will cover the growth of insurance business, any increase in the number of insurers, along with any material changes during the reporting period. They are likely to include projections for the coming year. The purpose is primarily to provide information and, unless major problems are indicated, little or no action is required by the oversight entity. This system of reporting is most useful in jurisdictions whose head is elected or, in a regulatory scheme where the oversight body has little control over the actions of an insurance supervisory authority. It is often useful to insurance managers if annual reports or, associated documents, set out the policies of supervision and any changes made. In many jurisdictions annual reports are publicly available documents.

A.6.2 Regular reporting

Written reports are required on a regular and fairly frequent basis. They are likely to be more inclusive than an Annual Report by including operational issues faced by an insurance supervisory authority as well as growth and changes within the insurance industry. Frequently these reports may be followed with an in-person 'question and answer' session that could include issues related to policy decisions of the head. This, more stringent oversight, would be suitable in a jurisdiction where an oversight entity has some control over the insurance supervisory department.

A.6.3 Regular reporting with some prior approval

In some instances it might be advisable to install a method of oversight which would require consultation and even prior approval before policy decisions are made by the insurance supervisory authority. This type of oversight is frequently preferred in countries seeking to overcome the image of strong bureaucratic power lodged in a single individual. By requiring frequent review and consultation, and shared power for poli-

cy decisions, the chances of strong and arbitrary exercise of power are diminished. Of course, there will also be less flexibility and an extended reaction time for the supervisory authority as a whole. The head might have less opportunity for extended powers because of close scrutiny.

A.7 ACCOUNTABILITY TO THE CONSUMER

Life insurance is sometimes the only way consumers use to save for old age while non-life insurance can protect individuals and corporations from expensive losses. The supervision of market conduct of insurance entities is designed to protect policyholders against the mis-selling of products and the incompetence of persons selling life insurance products.

A.7.1 Market conduct (IAIS Core Principle 11)

This aspect is considered in more detail in Module D where the full text of the IAIS Core Principle 11 (Market Conduct) is reproduced.

A.7.2 Accessibility of financial information

Many countries require insurers to publicize their financial reports so that the public can make educated decisions about their viability. Many insurance supervisory departments usually file such reports which are also readily available to the public. If it cannot be obtained from the department, the information can be accessed on either the insurer's or a department's website. There is often a charge for copying and mailing but usually no fee for access. The supervisory authority, in some instances, might consider it has met its responsibilities by making the financial data available to the public.

A.7.3 Ratings

Some departments provide consumers with ratings or rankings of insurers in their jurisdictions while others do not. They feel this could encourage partiality and favouritism which is not the role of a supervisory body. By receiving specific financial information, consumers have the opportunity to make informed decisions. Departments should also steer consumers to national and international agencies which are in the business of evaluating and rating insurers.

A.7.4 Mandated disclosure

Some supervisors believe they can fulfil the obligation to be accountable by requiring insurers or agents to disclose predetermined information and material facts to prospective purchasers before, or during the course of a sale. Insurers are sometimes required to disclose commission rates, company charges, interest rates if applicable, claims procedures and restrictions etc.

A.7.5 Specific services

Many supervisory authorities have a 'Consumer Affairs' section which is responsible for dealing with consumer issues and problems. It is this section to which most issues of accountability are referred. Actions taken by the department, disciplinary or otherwise, can be notified to both the public and the industry. This can include actions taken by a

supervisor following the receipt of complaints against insurance companies, agents or brokers.

In many jurisdictions, to ensure some degree of accountability and to protect against arbitrary and capricious actions by insurance supervisors, hearings and other formal disciplinary and rulemaking procedures are open to the public and subject to the administrative procedures of those jurisdictions. This often involves hearings conforming to the standards of 'due process' and 'the right to be heard'. This protection is generally considered essential for an organized, fair resolution of issues. If there is no national legislation regarding hearings, safeguards can be incorporated into the insurance statutes of a jurisdiction.

A.8 SUPERVISORY TOOLS

A.8.1 Statutes

Legislation regulating insurance business can be lengthy, complex and totally complete at one extreme or, at the other extreme, it can comprise policy statements and language enabling the supervisory authority to implement policy statements through supervisory action. The more complex the statute, the longer it takes to enact and put into place and the more difficult it is to amend. Detailed legislation reduces flexibility for supervisors and often prevents them from reacting speedily to economic and financial changes. Legislation also runs the risk of not being detailed enough and of having accidental omissions which might be construed as deliberate. If legislators wish to restrict an authority and the capacity of its head, the voluminous detail is often an effective method. Otherwise, particularly for a developing market, the process can be cumbersome and slow. It is important to remain consistent with the terms of existing contract, tax and administrative legislation as well as case law in some jurisdictions or carefully to denote that any divergence or contradiction is intentional. Certain elements must be contained within legislation to confirm the power and authority of the supervisor to perform key activities. Examples are - the right to conduct inspections, the requirement that insurers must provide requested information, the power to impose sanctions, the authority to set minimum standards for the evaluation of assets and liabilities, and for the maintenance of minimum solvency margins. The details can be in regulations and guidelines, but an authority's power must come from legislation.

A.8.2 Subsidiary legislation (regulations)

An option to provide more general legislation is available and could enable the head of a supervisory authority to devise regulations addressing the specific requirements indicated by the marketplace and prudent judgement. Using regulations to supervise insurance business can create situations whereby consumers, and insurers, face uncertainty as to how they can or cannot conduct their business. This can create feelings of instability which would, among other things, discourage foreign investment and reduce consumer confidence. It could be devastating in a jurisdiction with no track record and diminish confidence in the benefits of private insurance.

However this need not happen if regulations are produced with proper safeguards - i.e. due process, opportunities for comments, open hearings, etc., the consumers and industry become participants in the regulatory

process and may, therefore, be much more confident in its long-term viability. Regulations can also be put in place more expeditiously than legislation and can be adapted as needed to reflect change within the industry and the economy. Because new legislation is not required to amend or introduce new regulations, there is less call upon the political process.

This allows a greater independence for an insurance department and prevents the use of regulation as a political tool. The degree of regulation can vary and can be on a sliding scale depending on the sensitivity of a particular issue. A head might seek legislation for politically charged matters so as to avoid any personal political fall-out.

A.8.3 Sanctions

Withdrawal and/or suspension of licences of insurance intermediaries or insurers is an effective, albeit severe, method of promoting compliance with the statutes and regulations governing insurance. This is usually only used to discipline insurance companies accused of serious faults such as outright and intentional fraud or irrecoverable failure of solvency and insurance security. If sanctions are enforced, some arrangements must be made to protect existing policyholders. The possible removal or suspension of the licence of an agent or broker, however, can be extremely effective in preventing fraud or other unlawful acts. Any action involving the revocation or suspension of a licence should be accompanied by a hearing to allow accused individuals or companies to defend themselves against the charges. At times, impartial arbitration might be appropriate.

Fines are another means of exercising control over the insurance business. By levying fines for infractions, a department shows its seriousness in seeking to control the activities of those it regulates. Fines should be in keeping with the severity of infractions and should increase for repeated offences. The fines should not be so large as to place the solvency of a company in jeopardy; nor should they be so small as to be regarded simply as the cost of doing business. Fines are particularly effective when dealing with smaller operations such as agents and brokers who are more likely than large corporations to feel the negative effect.

It should be made clear that fines on insurers and intermediaries should be paid from shareholders' funds and not treated as a 'business expense' to be paid by policyholders.

Some jurisdictions do not have the ability to fine insurance entities except for minor offences such as late annual returns etc. These jurisdictions take the view that justice is the prerogative of the courts and not insurance supervisors.

A.8.4 Licensing

Licensing is the principal method of control over entry and exit of insurance entities and is dealt with at length in Module B and in the IAIS licensing textbook.

A.9 HUMAN RESOURCES AND CONFIDENTIALITY OF INFORMATION

The problems associated with staffing an insurance department are not confined to developing countries. They are universal and faced by all who must secure

competent employees while relying on often limited budgets funded by taxpayers. This section attempts to deal with some more immediate issues facing newly developed markets.

In discussing the staffing of insurance departments, staff are defined as those individuals who carry out the day-to-day tasks of the supervisory agency. They rarely make policy, but do implement it. They are the technicians who generally bring consistency to an agency and who remain after political appointees, if any, are transferred or replaced.

It is in the best interests of a supervisory body to maintain experienced staff with professional expertise and background knowledge. Care should be taken not to destroy employees' objectivity or allow them to be too strongly influenced by those they supervise by remaining too long in the same position.

A.9.1 Civil service staff

A staff comprised exclusively of civil servants will be about as good as the civil service system in any given jurisdiction. If the service is run as a meritocracy, based on exams, credentials and experience, with room for growth and advancement, then there is an excellent chance that the regulatory staff will be competent. However, in a developing or emerging market, it is quite likely that many of the human resources needed are not yet available. For example, in some jurisdictions there is little or no actuarial expertise or training, thus precluding the availability of locally trained actuaries. In such situations, the regulatory authority must be prepared to seek training for its staff so that an experienced, knowledgeable department can be created.

In more developed jurisdictions, insurance departments are often more concerned with offering competitive salaries since the training is already available. As private industry grows and prospers, it is often able to offer larger salaries and greater benefits than government. However, government bodies may compensate, at least in part, by offering more attractive hours and greater job security.

In newer and less developed markets, particularly where average incomes are low and/or there is moderate to large unemployment, government civil service positions may become much more desirable. The government may find it easier than the private sector to attract candidates and retain them. The issues of training and experience, however, could be acute.

A.9.2 External consultants

When insufficient experienced staff members are available or where minimal training opportunities exist, it is useful for a jurisdiction to seek personnel outside the civil service to temporarily augment their staff. Thus, trained personnel, either from domestic or foreign industry, might work with the regulatory authority on a temporary basis. Their major role can be to advise and train existing personnel so that eventually the consultant's participation will be unnecessary. Many jurisdictions and companies have internal programmes which permit such individuals to continue to receive their regular salary while assisting in the offices of a developing regulatory authority for a limited period.

Governments and industry in developed jurisdictions may also accept, as interns in training programmes, government employees from regula-

tory bodies in developing markets. Since these internships will have a narrower impact and are generally for limited periods, the programme is not as effective as sending experienced personnel to a department for a longer time in order to train indigenous staff.

These externally sourced 'assistants' are not replacements for civil servants. They are meant to enhance and accelerate the development and independence of staff. Today, more than ever, we have a global insurance market. This has been brought about by advances in technology which permit instant communication across oceans and time zones. Insurers also find they must follow clients who expand internationally, in order to continue offering a uniform and complete insurance service.

A.9.3 Confidentiality

During the course of his duties an insurance supervisor will often receive information that is commercially sensitive or of a personal nature.

The IAIS Core Principles, Essential and Additional Criteria are shown in the following box.

Confidentiality (IAIS Core Principle 17)

All insurance supervisors should be subject to professional secrecy constraints in respect of information obtained in the course of their activities, including during the conduct of on-site inspections.

The insurance supervisor is required to hold confidential any information received from other supervisors, except where constrained by law or in situations where the insurance supervisor who provided the information provides authorization for its release.

Jurisdictions whose confidentiality requirements continue to constrain or prevent the sharing of information for supervisory purposes with insurance supervisors in other jurisdictions, and jurisdictions where information received from another supervisor cannot be kept confidential, are urged to review their requirements.

Essential Criteria

1. An appropriate confidentiality requirement that all insurance supervisors should be subject to professional secrecy constraints in respect of information obtained in the course of their activities is embodied in law (either in the insurance law or in other laws applying to the behaviour of the insurance supervisor).
2. 'Gateways' that allow the insurance supervisor to pass confidential information to other supervisors or law enforcement bodies are clearly set out.
3. Freedom of information provisions do not override the confidentiality requirements applying to the insurance supervisor in situations where confidentiality is necessary for sound regulatory practice or effective communication with other regulators.
4. Insurance supervisors are able to hold confidential any information received from an insurance supervisor in another jurisdiction with an expectation of confidentiality.

A.10 CO-ORDINATION, CO-OPERATION AND INTERNATIONAL TRADE

Insurance and especially reinsurance are international in nature and there is a need for the sharing of information with supervisors of other types of financial institutions and with supervisors in other jurisdictions, while ensuring that the confidentiality of information is preserved. Where this is not automatically permitted in the legislation there will be a need for separate agreements that authorize the sharing of relevant information and preserve the confidentiality of that information.

The IAIS Core Principle and the criteria are shown in the following box.

A.10.1 Co-ordination and Co-operation (IAIS Core Principle 16)

Increasingly, insurance supervisors liaise with each other to ensure that each is aware of the other's concerns with respect to an insurance company that operates in more than one jurisdiction either directly or through a separate corporate entity.

In order to share relevant information with other insurance supervisors, adequate and effective communications should be developed and maintained.

In developing or implementing a regulatory framework, consideration should be given to whether the insurance supervisor:

- ◆ is able to enter into an agreement or understanding with any other supervisor both in other jurisdictions and in other sectors of the industry (i.e. insurance, banking or securities) to share information or otherwise work together;
- ◆ is permitted to share information, or otherwise work together, with an insurance supervisor in another jurisdiction. This may be limited to insurance supervisors who have agreed, and are legally able, to treat the information as confidential;
- ◆ should be informed of findings of investigations where power to investigate fraud, money laundering, and other such activities rests with a body other than the insurance supervisor; and
- ◆ is permitted to set out the types of information, as well as the basis on which information obtained by the insurance supervisor may be shared.

Essential Criteria

1. The insurance supervisor is able to enter into an agreement or understanding with any other supervisor both in other jurisdictions and in other sectors of the industry (ie insurance, banking or securities) to share information or otherwise work together.
2. The insurance supervisor is permitted to share confidential information, or otherwise work together, with an insurance supervisor in another jurisdiction. This may be limited to insurance supervisors who have agreed, and are legally able, to treat the information as confidential.
3. The insurance supervisor is permitted to set out the types of information obtained by the insurance supervisor that may be shared and the basis on which it may be shared.
4. Information sharing arrangements allow for a two way flow of information, but strict reciprocity in terms of the level, format and detailed characteristics of the information exchanged is not demanded.

Additional Criteria

1. The insurance supervisor is informed about findings of investigations where the power to investigate fraud, money laundering, and other such activities rests with a body other than the insurance supervisor.
2. In the case of insurers with foreign establishments, the insurance supervisor of the parent insurer will take the host supervisors into their confidence as much as possible.
3. The recipient of information provided by an insurance supervisor in another jurisdiction undertakes, where possible, to consult with that insurance supervisor if they propose to take action on the evidence of the information received.
4. The insurance supervisor of the parent insurer with foreign establishments informs the host supervisors of those establishments of any material changes in supervision which may have a significant bearing on the operations of such establishments.
5. Where an insurance supervisor has doubts about the standard of host supervision in a particular jurisdiction and, as a consequence, is anticipating action that will affect the foreign establishments in the jurisdiction concerned, they will consult with the host supervisor in advance.
6. If a host supervisor identifies, or has reason to suspect, problems of a material nature in a foreign establishment, it takes the initiative to inform the insurance supervisor of the parent company and provides prior warning of any regulatory action intended.
7. An insurance supervisor is able to obtain information on behalf of an insurance supervisor in another jurisdiction, or otherwise co-operate with that supervisor.

A.10.2 Regional and global networking

Technology and the global market have created new imperatives and opportunities for insurance supervisors. They can now create regional and global networks which provide data about insurers operating internationally and which enable them to share problems and solutions. Many of these networks are already in place and are functioning on an increasingly comprehensive level each year. They may be global like the International Association of Insurance Supervisors (IAIS), regional like Asociación de Superintendentes de Seguros de América Latina (ASSAL) or national like the National Association of Insurance Commissioners (NAIC), a United States group has grown from an informal discussion group to one that has established uniform minimum standards independently of the fifty State legislations. The ASSAL has moved from sporadic meetings to annual gatherings of regulators. The IAIS is the first global insurance organization whose members have pledged to share information concerning companies operating in their jurisdictions and the management of those companies.

These organizations (and many additional counterparts around the world) are invaluable resources for developing countries and emerging insurance markets and should be utilized by the appropriate supervisors. They can quickly supply reliable information and are particularly helpful to under funded and under staffed supervisors.

A.10.3 Extraterritoriality

Some jurisdictions try to extend their laws and regulations beyond the borders of their own jurisdiction. For example, they might attempt to stop their citizens purchasing insurance from any company other than a national company or, if an industry is privatized, from a domestic and usually 100% indigenously owned company-even if such purchases are undertaken entirely outside a jurisdiction. These, and other attempts to extend jurisdiction beyond a jurisdiction's borders, are seldom effective even when enforced by some of the world's most powerful jurisdictions. Due to limited resources-both in funding and in personnel, smaller, newer markets may have even greater difficulty demanding or policing compliance with such rules which are, therefore, often circumvented on a regular basis. It is even more difficult for newer and smaller markets to implement extraterritorial powers. Smaller markets will invariably have insufficient capacity to cover the many and varied classes of insurance available. Insurance supervisors in smaller or emerging jurisdictions need to address the problem of, for example, agents from another jurisdiction making short visits and accepting applications and premiums from hotel rooms for policies to be issued from their home domicile.

A.10.4 Multinational markets

It is vitally important for insurance supervisors in emerging jurisdictions to recognize that they are operating in a global, multinational market. In other sections of this manual we discuss foreign investment and market penetration, money laundering, foreign currency, policy and premiums, and related issues. An international perspective needs to be incorporated into the regulation and projected growth of any emerging marketplace because, currently, it is often impossible to develop a closed, purely domestically driven industry.

SUMMARY

This module has outlined some of the basic considerations for establishing or continuing government supervision of insurance. It also emphasizes the importance of supervisory co-ordination and co-operation both within a jurisdiction and across borders. Further information on some of these matters are elaborated in modules C and D.

The alternatives discussed in each section range from a tightly controlled, generally integrated supervisory authority at one end, to an independent, free-standing entity at the other. Each supervisory authority must determine its place among the alternative approaches in order to meet the needs of its growing insurance industry.

The major premiss permeating all modules is that regulation is a continual process.

Supervision, as an evolving process, can be illustrated by the changes in the statutes and supervisory structures of Poland and Estonia. Each began with supervisory bodies established as integral parts of a Ministry of Finance. There are now independent regulatory bodies supervising their insurance companies and markets.

This module, combined with the others, is intended to help in fostering the evolution of insurance supervision throughout the world and to explain the rationale of insurance supervision to new entrants in insurance supervisory departments.

MODULE B

SUPERVISORY FUNCTIONS & POWERS

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SUPERVISORY FUNCTIONS AND POWERS

INTRODUCTION

One cannot over emphasize the overwhelming need for insurance supervisors to monitor and enforce strict solvency standards. Nor should the need for insurers to operate in a transparent manner, which is fair and equitable to policyholders and consumers, be minimized. The most effective supervisory tool for this purpose is the licence which must be held by an insurer wishing to conduct insurance business within a jurisdiction. Licensing is a tool which controls entry to and exit from the insurance market. Statutory and regulatory requirements, which are prerequisites for securing and/or maintaining a licence, enable supervisors to control and enforce predetermined standards of conduct and levels of solvency. Whether these requirements are part of insurance law, contract law or supervisory regulation will vary from one jurisdiction to another but their place as necessary tools for the effective regulation of insurance is unquestionable.

In this module we deal with licensing and monitoring of conduct other than solvency. Module C concentrates on financial and related issues.

B.1 LICENSING

The licensing system is the key to entry to and exit from the insurance market in any jurisdiction and differs greatly between jurisdictions across the world.

The IAIS Core Principles, Essential and Additional Criteria are shown in the following box. They are also included in the IAIS textbook on licensing.

B.1.1 Licensing (IAIS Core Principle 2)

Companies wishing to underwrite insurance in the domestic insurance market should be licensed. Where the insurance supervisor has authority to grant a license, the insurance supervisor:

- in granting a license, should assess the suitability of owners, directors, and/or senior management, and the soundness of the business plan, which could include pro forma financial statements, a capital plan and projected solvency margins; and
- in permitting access to the domestic market, may choose to rely on the work carried out by an insurance supervisor in another jurisdiction if the prudential rules of the two jurisdictions are broadly equivalent.

NOTE: This Principle is divided into three component parts. The Supervisory Standard on Licensing should be referred to in order to obtain a full view of licensing and changes in control.

2(1): Companies wishing to underwrite insurance in the domestic insurance market should be licensed.

Essential Criteria

1. Legal provisions on licensing are in place through the insurance supervision law.
2. These legal provisions define the types of company or entity that are insurance companies or entities, and the insurers which must be licensed or define insurance business and prescribe that all of entities writing insurance business must be licensed.
3. These legal provisions also contain regulations defining the authority responsible for licensing, its tasks, and the licensing requirements.

Additional Criteria

1. The licensing authority makes directives or guidelines available to insurance companies. These directives or guidelines give information on the requirements that are to be met if the licence is to be granted.
2. A regulation on what is to be considered 'insurance business' exists, either in a law or in the established practice of the courts.

2(2) The insurance supervisor, in granting a licence, should assess the suitability of owners, directors, and/or senior management, and the soundness of the business plan, which could include pro forma financial statements, a capital plan and projected solvency margins.

Continued . . .

Core Principle Continued . . .

Essential Criteria

1. The permitted types of legal form are defined.
2. Legal provisions exist on whether key functionaries such as owners, directors and/or senior managers are fit and proper (ie possessing the necessary knowledge, skills and integrity for their provision).
3. As regards owners, the provisions require the following:
 - The insurance supervisor is to be informed of the names of the natural and legal persons holding a direct or indirect qualifying participation in the applicant company.
 - The insurance supervisor has the authority to refuse to issue the licence to operate if facts exist from which it can be deduced that the holders of a qualifying participation:
 - are in economic situation which may be hazardous to the soundness of the applicant;
 - do not have sufficient resources to keep the company solvent on an on-going basis;
 - are or have been directly or indirectly involved in illegal transactions affecting their suitability, or intend to abuse the insurer for criminal purposes (eg money laundering); or
 - are connected with the applicant company in a way that would obstruct or render effective supervision impossible.
 - Criteria similar to those applied to directors and/or senior management (see below) can be applied to check the reliability of natural persons. As far as legal persons are concerned, the insurance supervisor applies the criterion of suitability to the persons running the company; the insurance supervisor is authorised to ask for submission of audit reports and other key information such as extracts from the statutory records (the register of commerce).
 - The insurance supervisor has the power to exchange information with other relevant authorities inside and outside its jurisdiction which respect minimum reciprocity and confidentiality requirements.
4. As regards directors and/or senior managers (key functionaries), the insurance supervisor should assess their fitness and propriety as follows:
 - Fitness tests seek to assess the competence of managers and directors and their capacity to fulfil the responsibilities of their positions while propriety tests seek to assess their integrity and suitability;
 - The requirements could, however, depend on the area for which the person concerned will be responsible given that all necessary qualifications are present on the board of directors; and
 - If, in special cases, senior management functions (eg authorised representative of a foreign branch) are performed by a company (legal person), the insurance supervisor should be assured that the representatives of that company are qualified, reliable and of good repute.

Continued . . .

Core Principle Continued

5. The insurance supervisor has the authority to deny the licence on the basis of facts from which it could be deduced that the person concerned will not manage the insurance company in a proper fashion (a previous conviction especially for an offence committed in connection with financial services; participation in unsound transactions; bankruptcies caused by dishonesty; tax evasion).
6. Within the framework of the fit and proper test (the test of possessing the necessary knowledge, skills and integrity for his/her position), the applicant is required to submit a complete curriculum vitae and to provide a declaration from the proposed owners and directors/senior managers confirming that no criminal proceedings are or have been pending against them.
7. The applicant is required to submit a business plan outlining the proposed business of the company for at least three years ahead.
8. The business plan provides information on the types of obligation the company proposes to incur (in the case of life insurance); the types of risk it proposes to cover (in the case of non-life insurance); the basic principles of the company's insurance and reinsurance program; the estimated setting-up costs and the financial means to be used for this purpose; and the projected development of business and capital or solvency margins.
9. A minimum amount of capital is required for all insurance companies.
10. The insurance supervisor has the ability to check affiliation or outsourcing contracts and, where material, exercise this ability.
11. The insurance supervisor has the authority to request and check information on the products offered by the insurer (general policy conditions, technical basis for the calculation of premium rates and provisions).
12. The documents of formation as well as information on actuaries and auditors are to be provided.
13. A company licensed to operate life insurance should not also be licensed to operate non-life insurance and vice versa, unless there are clear provisions, which the insurance supervisor finds satisfactory, requiring that risks be handled separately on both a going-concern and a winding-up basis.
14. The insurance supervisor has the right to withdraw the licence on the grounds of substantial irregularities; eg if the company no longer meets the licensing requirements or seriously infringes the law in force.
15. Where an authority granting licences is different from that conducting on-going supervision,
 - The authority granting licences ensures that the legal and prudential criteria which are applied in the process of checking the licence application are in line with the criteria on which on-going supervision will be based;
 - The authority in charge of on-going supervision is given the right to check the application documents and give its opinion;
 - The insurance supervision law provides that the authority in charge of on-going supervision is to be notified of changes in criteria that are relevant for granting the licence;

Continued

Core Principle Continued

- The authority in charge of on-going supervision is informed of the reasons for which the licence was granted or denied; and
 - If the authority in charge of on-going supervision has objections to the licence being granted, and if it is granted irrespective of such objections, the reasons for granting it are documented.
16. The insurance supervisor provides insurers with information detailing the documents they are required to submit to the insurance supervisor.

Additional Criteria

1. When checking the documents submitted, the insurance supervisor refers to reports on checks made by other bodies such as auditors and other regulatory bodies.
2. Directors/senior managers should not hold two positions that would result in a material conflict (eg appointed actuary and CEO).

2(3) The insurance supervisor, in permitting access to the domestic market, may choose to rely on the work carried out by an insurance supervisor in another jurisdiction if the prudential rules of the two jurisdictions are broadly equivalent.

Essential Criteria

1. The insurance supervisors of competent authorities share information when foreign insurers are to be licensed.
2. When licensing a foreign insurer, the insurance supervisor may choose to rely on the information supplied by the insurance supervisor in the jurisdiction where the insurer's head office is situated (home supervisor), provided that the host supervisor treats the information it obtains as confidential and protects it appropriately.

B.1.2 Case-by-case basis

Some jurisdictions, especially small ones, prefer to evaluate every licence application in isolation rather than en bloc. This enables supervisory authorities to distinguish between different applicants and the kinds of business they propose. Other jurisdictions have established different requirements for companies selling only to residents and for those planning only 'offshore' sales. Although this case-by-case approach gives supervisory authorities flexibility in dealing with the specific needs of applicants, it needs to be structured to provide support for the supervisor in his examination of the company and his need for additional information. This procedure can be open to abuse and arbitrary decision-making and may not meet the needs of most emerging and growing markets. The case-by-case basis works only if supervisors are able to impose separate standards on the individual insurers licensed and when these separate standards have a statutory basis, eg the impositions of conditions on a licence.

B.1.3 Statutory requirements

The application process for a licence to carry on the business of insurance is usually a complex procedure requiring information about many aspects of a company's proposed operation. If the company seeking a licence is a subsidiary, detailed information should also be sought about the parent. Even in jurisdictions whose statutes require only that a company be 'registered' or 'listed', a supervisory authority will usually investigate the ownership, the capital reserves and business plan of every new entrant.

A business plan should project the anticipated first three to five years of an applicant company's operations. Every plan should include anticipated financial projections of premiums and investments, capital and surplus and start-up and operating expenses. Plans might also detail the types of products and marketing methods. Some jurisdictions require sample policies to be submitted. Also, since it is rare for a jurisdiction to permit one company to carry on both long-term (life) and general insurance, an applicant usually needs to stipulate its intended line of business. The rationale for this is that the financial risks of life and non-life insurance are so different that it would be difficult to control solvency. In countries where it is allowed, two distinct sets of financial records are required.

An applicant should be asked to supply information concerning proposed methods of distribution and plans for training sales personnel, if applicable. Planned commissions, benefits and incentives for agents and brokers should be included as part of the application. Some jurisdictions, particularly those with little or no prior regulation of sales, might wish to view copies of prepared marketing literature and/or internal training material for sales personnel to ensure they contain no misrepresentations or abuses.

An application should contain such basic information as - the name of the company, the identities of controlling individuals (including major shareholders) and the names of prospective senior managers. Extensive biographical background data indicating prior experience, education and relevant personal information (eg residences, honours, hobbies) is likely to be requested about each individual. As noted in Module A, some countries then review this information in great detail. Others view it as a pro forma requirement which should reveal any gross misbehavior. A prospective staffing plan may be requested even though all positions might not be filled immediately.

Some countries also have statutory requirements regarding the selection of insurance company names. For example, some jurisdictions require the word 'insurance' be used; others require that 'life' be used in the name of a life assurance company. Some permit the use of 'assurance' company, while others prohibit it. Most ban the use of the word 'group' unless it is accurate. Rules vary and are often tailored to fit the history and culture of insurance in any given jurisdiction. Some statutes limit an insurance company to conducting insurance business only.

In addition to information about the location of an applicant company's head office (including the address where its financial records are stored), its place in the overall corporate structure of a holding company system, any service or management agreements either within the corporate family or between the insurer and an independent outside company, and any reinsurance agreements, must all be noted or submitted for review or approval. Some jurisdictions expand this procedure to include the production of a reinsurance programme as a prerequisite.

Key information, when evaluating an application, includes the amount of initial capital involved and the amount of capital and surplus projected over the dura-

tion of a business plan. Some insurers are able to set out the total amount of aggregate risk that they will retain. In these instances supervisors will be able to compare annual figures with funds available. The initial amount of required capital will vary. It is usual for financial projections submitted as part of a business plan to include a prediction of set-up or acquisition costs and initial marketing expenses as well as projections once business has commenced.

1. Usually there is a set minimum level for capital and reserves which every licensed insurer must adhere to-irrespective of size or business projections. This is frequently described as a 'guarantee fund' or 'guarantee level' (having no relationship to the US guarantee funds which will be discussed later) and, although the amount initially required by a supervisory authority can rise above that level-it may never go below it. This is generally a statutory requirement. In practice, a supervisor frequently increases the level of required capital as the level of business increases. In countries which do not require, or do not monitor reinsurance programmes, the capital requirements might be higher.
2. Some jurisdictions have no statutory minimum capital, opting, instead, to decide requirements on a case-by-case basis. Others have a sliding scale of capital requirements which are directly related to the size, projected amount and type of business to be undertaken.

Much of the review process, especially of business plans, is judgmental and not something that can be supplied in advance, hence there is a need for supervisory personnel who are at least as skilled as the proposed chief executives of an applicant company.

When all required information is compiled and submitted, it is usual for representatives of the applicant company to meet representatives of the regulatory body to review an application on an 'informal' and 'unofficial' basis. At this meeting, a supervisor will seek any additional information needed before the application can be processed. A supervisor may also suggest modifications to proposed business plans or ask questions or give advice on other parts of an application. These meetings are best described as 'negotiating sessions' in which both parties seek the best plan to suit their goals. Levels of solvency, capital resources and methods of conducting business are agreed and which will satisfy both the regulator and the applicant. Should mutual agreement not be reached, a supervisory authority clearly is the final authority.

When agreement is reached, the application is then formally submitted, officially reviewed, and approved or denied. Approval is not automatic and can be subject to changes and modifications to planned operations, personnel or other projected data. Many jurisdictions require that a written reply is given to the applicant within a set time - usually sixty to ninety days. If an application is rejected, the reasons for denial may have to be given in writing and a company should have an opportunity to resubmit its application, with changes, for reconsideration. There is usually a statutory time-frame for resubmissions. The size of a supervisory authority, the number of insurance companies, and the size of the potential market will all have an effect on the complexity of the application process. Generally, the smaller the insurance community and the consuming public, the simpler an application process will be.

It would be wrong for an applicant to assume that once all the relevant forms have been completed a licence is automatically granted. The award of a licence depends on a combination of factors within the application process and a final decision is often made by an insurance supervisor on a subjective basis.

B.2 CONTINUING SUPERVISION

B.2.1 Changes in control and sanctions

A change in control of an insurance entity is as important to a supervisor as are the fit and proper criteria of licensing. Therefore, it is recommended there is some kind of approval process.

Where the insurance entity is owned by a body (either in the same jurisdiction or in another jurisdiction) which itself is a large conglomerate and vulnerable to a take-over it may not be practical for approval to be sought, especially if the insurance entity is an insignificant part of the group. In such cases, an insurance supervisor should be able to take action if it is considered that the new controller has created a situation which is not in the best interests of the insurer or its policyholders.

The IAIS Core Principles, Essential and Additional Criteria are shown in the following box.

B.2.2 Changes in control (IAIS Core Principle 3)

The insurance supervisor should review changes in the control of companies that are licensed in the jurisdiction. The insurance supervisor should establish clear requirements to be met when a change in control occurs. These may be the same as, or similar to, the requirements which apply in granting a license. In particular, the insurance supervisor should:

- require the purchaser or the licensed insurance company to provide notification of the change in control and/or seek approval of the proposed change; and
- establish criteria to assess the appropriateness of the change, which could include the assessment of the suitability of the new owners as well as any new directors and senior managers, and the soundness of any new business plan.

Essential Criteria

1. The insurance supervisor is required by law to be notified of changes in control by the party acquiring the participation or by the insurers.
2. The law defines such changes and permits the insurance supervisor to take into account the substance as well as the form of the transaction.
3. The insurance supervisor has the power to assess the change in control and take the necessary measures.

Additional Criteria

1. The insurance supervisor regularly obtains information from the insurance companies on the holders of participations in such companies exceeding a designated threshold, either by means of reports submitted by the insurers, or on-site inspections.
2. The insurance supervisor develops criteria on the basis of which the changes in control are assessed. As a minimum, the suitability of the new owners, directors and senior managers, and the soundness of any new business plan are checked when a change in control occurs.

Continued . . .

Core Principle Continued

The specific documents that the insurers have to submit depend on the licensing requirements of the jurisdiction and are consistent with the documentation required for new licence applications.

The IAIS Core Principles, Essential and Additional Criteria are shown in the following box.

B.2.3 Sanctions (IAIS Core Principle 14)

Insurance supervisors must have the power to take remedial action where problems involving licensed companies are identified. The insurance supervisor must have a range of actions available in order to apply appropriate sanctions to problems encountered. The legislation should set out the powers available to the insurance supervisor and may include:

- the power to restrict the business activities of a company, for example, by withholding approval for new activities or acquisitions;
- the power to direct a company to stop practices that are unsafe or unsound, or to take action to remedy an unsafe or unsound business practice; and
- the option to invoke other sanctions on a company or its business operation in the jurisdiction, for example, by revoking the licence of a company or imposing remedial measures where a company violates the insurance laws of the jurisdiction.

Essential Criteria

1. The insurance supervisor has the authority to refuse or revoke a licence if the organizational (or group) structure of the applicant or licensee hinders the effective supervision.
2. The insurance supervisor has the authority to act if it determines that the board of directors and senior management of the institution do not understand the underlying risks in their business or are not committed to, and accountable for, the control environment. The insurance supervisor has the legal authority, upon sufficient proof of an insurer's hazardous condition, to require changes in the composition of the board and/or senior management in order to satisfy these criteria.
3. The insurance supervisor has the legal authority to take remedial action against companies and impose sanctions. Remedial actions consistent with the severity of the situation are used to address such problems as failure to meet prudential requirements, violation of regulations, or situations where the interest of policyholders might be threatened.
4. The range of possible available sanctions is broad, ranging from penalties, fines, restricting the current activities of the company, withholding approval of new activities to revoking licences or imposing conservatorship and the forced transfer of portfolio.
5. The insurance supervisor ensures that remedial actions are taken in a timely manner.

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Core Principle Continued . . .

6. The insurance supervisor addresses all significant remedial actions in a written document to the board of directors as well as to the company itself, and also requires that progress reports are submitted in writing.
7. Upon determining that a company is unsound, the insurance supervisor asks the ailing company to submit a recovery plan within a relatively short period, eg one month, which among other things should:
 - list the financial or administrative measures proposed by the company to improve its situation; and
 - quantify the expected effects of those measures and estimate the amount of time needed to obtain visible results.
8. Implementation of the plan can be accompanied by safeguards if the insurance supervisor does not trust the current management's capacity to carry out the recover plan; for example:
 - restrictions on the freedom to dispose of assets;
 - appointment of a temporary administrator in place of the current management; and/or
 - suspension of payments.
9. These safeguard measures can also be taken if a company refuses to produce the requested plan, if a proposed plan is not approved by the insurance supervisor or if a plan, once approved, is not implemented.
10. The insurance supervisor asks the company to take, within a given period and under threat of penalties, all measures necessary to restore or reinforce its financial equilibrium, or remedy its practices.
11. If an agreement improving the situation of the policyholders cannot be reached, the insurance supervisor pronounces a penalty proportionate to the defaults of the company. A public reprimand, a bar on carrying out certain operations, or the temporary suspension of a manager are examples of penalties that may be imposed when the continuation of the business is not in question.
12. When no external support can be found, and the situation of the company can only keep deteriorating to the detriment of the policyholders, the insurance supervisor must put an immediate stop on the company writing new business, and consider forcing a transfer of portfolio, a withdrawal of all licences and liquidation.

Additional Criteria

1. The insurance supervisor applies penalties and sanctions not only to the company, but, if and when necessary, also to management and/or board of directors.

B.2.4 Other supervisory aspects

Regular reporting, on-site inspections and market conduct supervision are all essential elements of continuing supervision. These elements are more comprehensively covered in Modules C and D.

B.3 SCOPE OF AUTHORITY

The extent of supervisory authority is dependent, to some degree, on the legislative system of a jurisdiction and its legal traditions. The following are some of the different types of authority used in different jurisdictions.

B.3.1 Limited authority

The power of an insurance supervisor can vary widely. In some jurisdictions it is circumscribed by statute. The head is granted authority to regulate certain aspects of insurance business with few powers to exceed his statutory authority. These parameters are often preferred by jurisdictions which were previously part of a totalitarian or bureaucratic regime and where there might be distrust of placing excessive power in the hands of one individual or group of individuals. This type of leadership is often embedded in a complex, all-inclusive, detailed insurance law. The goal is to leave little to the discretion of any single individual so there is little room for abuse of power.

B.3.2 Broad authority

Although there are statutory guidelines regulating the power of a chief, there is usually a phrase or clause which empowers actions 'in the best interests of the policyholders'. This grants broad discretionary power which can be exercised even when there is no indication that an insurer has failed to comply with a particular statute. Thus, a commissioner can stop an insurer from taking a specific action, even when permitted by statute, if he believes it is against the best interests of the company's policyholders. Frequently, the only recourse on the part of the insurer is to go to court to show that the action was arbitrary, capricious or, in some jurisdictions, prejudicial. This broad discretion places tremendous power in the hands of a commissioner and is, therefore, primarily viable in regimes where power is centralized or where the rights of policyholders and consumers are given high priority. Such jurisdictions frequently have a number of other consumer protection measures in place.

B.3.3 Limited discretion

A compromise position might be one in which guidelines are mandated by statute but, within those guidelines, a commissioner has a broad level of discretion. In addition, protective remedies can be put in place to limit any misuse of such discretion. For example, hearings, administrative procedures, independent arbitration, easy access to judicial and/or administrative review etc. are all techniques which can help stop abuse or misuse of power by a supervisory authority.

B.4 FOREIGN PARTICIPATION - FORM OF INVESTMENT

B.4.1 Branch

When foreign insurers are licensed to establish and operate a branch office, insurance supervisors are in effect bringing the company under their regulatory jurisdiction. Supervisors should have all the assets of the foreign company at their disposal in case of insolvency or other financial difficulties. However, companies are not prevented from closing branches or ceasing to do business. Nor is a supervisor necessarily dealing with the realities of the situation. If the foreign company is a major global player, it will be difficult, if not impossible, to

exercise much day-to-day control over the operations of its home office. Nor will it be likely that the home country regulator will release control of assets maintained in that country. Thus, although a branch might seem to provide a regulator with control, without additional means of regulation, a supervisor could find that control is only apparent. Any issues requiring judicial interpretation might need to be processed through the legal system of the home country rather than where the branch is located. Supervisors can require capital deposits, perhaps in specified assets, but this can sometimes create difficulties in the home country of the company. Nevertheless, in some small jurisdictions there may not be sufficient business to warrant the establishment of a local subsidiary company and a branch may be the most practical way to establish foreign investment and competition. Contact with the home country supervisor is an important element of the supervisory process.

B.4.2 Domestic company

When a foreign company establishes a domestic subsidiary in order to do business, the supervisory authority has the same degree of control over that subsidiary as over any other company licensed and established under its jurisdiction. Admittedly, the free-standing subsidiary can separate itself from the assets of its parent but a regulator can require bonds or other financial arrangements to secure the protection of policyholders. By requiring that business be carried on only through a domestic company, a supervisor retains control of the investments, capital, products and personnel on a direct and enforceable basis. A subsidiary can be controlled, while there is less control over a branch. By requiring a guarantee from the parent for the subsidiary, long term support can be encouraged. In the USA, for example, some states require a parent company to lodge a guarantee in respect of the capital and surplus of a subsidiary for a period of years. Without such a guarantee, which can be for five or ten years, or any period designated by statute, or at the discretion of a supervisory authority, a subsidiary will not be allowed to conduct business. This type of requirement is onerous and expensive for a parent company which is only likely to establish a subsidiary if the volume of prospective business justifies the expense.

B.4.3 Joint venture

Insurance supervisors can help domestically owned companies to maintain dominant positions in a new market by establishing a maximum percentage of foreign ownership and control which can be permitted. A number of countries require foreign interests to establish a joint venture with a domestic company. The foreign partner is usually not permitted to own more than 49% of the entity.

While securing the competitive position of home companies, this policy allows greater opportunities for foreign investors and the greater use of foreign expertise. Joint venture companies provide regulators reasonable assurance that foreign capital and expertise will be combined with cultural experience and economic awareness.

B.4.4 Cross-border business operations

The IAIS Core Principles, Essential and Additional Criteria are shown in the following box.

Cross-border business operations (IAIS Core Principle 15)

Insurance companies are becoming increasingly international in scope, establishing branches and subsidiaries outside their home jurisdiction and sometimes conducting cross-border business on a insurance service basis only. The insurance supervisor should ensure that:

- no foreign insurance establishment escapes supervision;
- all insurance establishments of international insurance groups and international insurers are subject to effective supervision;
- the creation of a cross-border insurance establishment is subject to consultation between host and home supervisors; and
- foreign insurers providing insurance cover on a cross-border services basis are subject to effective supervision.

Note: Principles Applicable to the Supervision of International Insurers and Insurance Groups and their Cross-Border Business Operations should be referred to in order to obtain a full view of cross-border business operation principles.

Essential Criteria

1. The insurance law under which the insurance supervisor operates requires that all insurance establishments of international insurers, insurance groups and conglomerates operating within the jurisdiction be subject to continuing effective prudential supervision - irrespective of any licensing requirements.
 - In the case of the insurance subsidiaries of foreign parent companies, and insurance joint ventures in which one or more of the parent institutions is incorporated in a different jurisdiction, the law requires that these be subject to supervision of their capital adequacy/solvency in the host jurisdiction where they are incorporated.
 - In the case of foreign branches which are an integral part of an insurer incorporated in another jurisdiction then either:
 - the law provides for continuing direct supervision in the host jurisdiction; or
 - the insurance supervisor is able to demonstrate that they have a sound basis on which to believe that the insurance supervisor of the company in its home jurisdiction exercises continuing effective prudential supervision over the company as a whole, including its branch operations in foreign jurisdictions.
 - The insurance supervisor's standard procedure for considering the application for a licence for:
 - a subsidiary of a foreign insurer;
 - a joint venture in which one or more of the parent institutions is an insurer incorporated in a different jurisdiction; or
 - a branch of a foreign insurer;
- includes the need to consult the insurance supervisor of the parent insurer.

Continued . . .

Core Principle Continued . . .

2. Where the cross-border promotion of insurance contracts on a services basis is permitted, the insurance supervisor in the host jurisdiction has one (or a combination) of the following in place:
 - a procedure whereby foreign insurers are required to notify the host supervisor of their intention to promote insurance contracts;
 - a special licensing procedures; or
 - specific safeguards to protect policyholders.

Where a notification or special licensing procedure is used, then it includes checks that the foreign insurer is subject to continuing effective prudential supervision in its home jurisdiction over its global activities.
3. The insurance law provides the host supervisor with the powers to be able to assess on a case by case basis, whether to license, continue to license or otherwise permit, an insurance subsidiary or branch of a foreign institution to operate in its jurisdiction. The process should be transparent.
4. The insurance supervisor has the ability to refuse a licence for a foreign establishment in its jurisdiction, or impose additional conditions on a licence, where it has material concerns that the foreign parent insurer is not subject to continuing effective supervision in its home jurisdiction. The process should be transparent.
5. The insurance law provides the insurance supervisor with the power to prevent insurers established within its jurisdiction from promoting contracts of insurance through a branch or on a cross-border services basis in foreign jurisdictions where the insurer does not have the required financial capacity, or the necessary expertise, to manage the business prudently.
6. The home supervisors of insurers with overseas establishments require those insurers to maintain a sound and verifiable system of reporting from any foreign establishment to the head office.
7. Insurance supervisors exchange information, as necessary, on the operation in their jurisdictions of the insurance establishments of foreign insurers.

Additional Criteria

1. Home supervisors have the powers to order independent checks on data reported by an individual foreign establishment.
2. Insurance supervisors advise each other on a timely basis of any significant action they propose to take affecting the operations of a cross-border establishment.
3. Host supervisors accept on-site inspection of the branches of foreign insurers in their jurisdiction under the following conditions:
 - The home supervisor will inform the host supervisor of both commencement and conclusion of any examination of the host country branch.

Continued

Core Principle Continued

- The home supervisor and the host supervisor may communicate with each other on the initiative of either party. The home supervisor would share the necessary information with the host supervisor to a reasonable extent, subject to any statutory provision.
- The information obtained by the home supervisor in the course of inspections and meeting with the host supervisor shall be treated as confidential and shall be used solely for supervisory purposes, according to applicable legislation.

B.5 CONTROL OF UNDERWRITING AND CLAIMS HANDLING PRACTICES

Insurance companies, by the very nature of their business, are exposed to risk. Insurance companies should comply with prudential standards established to limit or manage the amount of risk that they retain.

In establishing the requirements a supervisor should consider whether standards that apply to companies that are incorporated within their jurisdiction should differ from those that apply to branches of companies which are incorporated in other jurisdictions.

B.5.1 Product control

Strong product control

Some jurisdictions believe that to achieve high quality consumer protection, it is necessary to control insurance products sold within a territory. This is accomplished by using one or more of the following mechanisms.

Mandated benefits: A company does not have to sell any particular product but if it chooses so to do, it must include certain benefits stipulated in law, or by regulation. For example, health insurance might be required to include maternity benefits and treatment for alcohol or drug abuse. Property insurance might have to include fire insurance and automobile insurance might have to provide cover for rental cars.

Mandated clauses: These may be required instead of, or in addition to, mandated benefits. Such clauses are almost exclusively for the benefit of consumers. For example, in all 51 States of the USA, consumers have ten days to review and return a life policy after it has been delivered. The premium must be refunded if a policy is returned, for any reason, during those ten days but, if the insured has died during that period, the insurer is still liable to pay the benefits of the policy. Sometimes an insurer is given a set period in which to contest the truth of statements made on an insurance application. After that time, benefits must be paid. In life and health coverage, policies cannot be cancelled if premiums are not paid within thirty days of the due date.

Prior approval: In addition to the inclusion of certain clauses and benefits being mandatory, it is common for jurisdictions to require that the wording of a policy is approved before it is offered for sale. This enables a regulator to be satisfied that a policy is fair to the consumer and that the insurer is in a financial position to undertake the risks covered in the policy.

In countries with a structured regulatory system and a strong interest in protecting consumers broad regulation of policies is found. The reason is that a regulator will be aware of the business generally undertaken by insurers in his jurisdiction and should have a better understanding of the risks involved. It does, however, slow down the process of bringing new products to the market and can inhibit competition. If an insurer is competing with other financial service institutions, whose products are not subject to similar scrutiny, the competitive problem increases. Another method used by some regulators is to have products certified by a professionally qualified employee (eg a company actuary) of the insurer or by external consultants to ensure the products are fair to consumers and that the insurer has sufficient financial resources to accept the risks. In instances of compulsory insurance (eg automobile, workers' compensation etc.) mandatory minimum benefits and mandatory clauses apply.

Even where there is no prior approval of products, a supervisor will probably specify standard conditions for the wording of policies and definitions.

Limited product control

The other extreme is limited product control based on the premiss that insurers should have the freedom to offer perceived market needs. It assumes consumers are sophisticated. This view is sometimes combined with the strong regulation of brokers and agents to ensure that the marketing of these products is done in an acceptable and professional manner.

This 'laissez-faire' approach to product control might be risky in an emerging market in which consumers are not experienced or educated in the need for, and purpose of, insurance. It could give rise to questionable products with high premiums and little chance of producing or paying benefits. This is particularly true if the products are being distributed by individuals and companies who are themselves new to the development and sale of insurance products.

Middle ground

It is possible to control products without getting immersed in complex statutory requirements. First, mandatory benefits can be eliminated or restricted to those essential for public welfare only. The mandate can be made more acceptable by allowing prices to be controlled by market forces.

Usually it is necessary to insist on the inclusion of clauses for consumer protection, but it is not always necessary to obtain advanced approval of all the terms of every policy. Policy reviews could be substituted for advanced approval, with a presumption that the sale of such policies should be allowed. Only policies with egregious provisions, which would be harmful to consumers should be questioned and restructured. This approach permits a supervisory authority to monitor products without curbing innovation or market influence.

Some jurisdictions require advanced filing of product literature and then allow insurers to use those products without going through an approval process. This method allows an insurance supervisor to intervene when necessary.

B.5.2 Underwriting options

Statutory requirements

It is possible for minimum and maximum underwriting criteria to be established by statute or regulation but, except in special circumstances, this does not nor-

mally happen. When such restrictions are in place, they will usually apply only to what is not permissible as an underwriting tool. For example, in some jurisdictions, gender may not be used as a factor in underwriting life and health insurance, age, or place of residence, may not be used for underwriting automobile insurance.

These criteria are useful in ensuring that some social needs are met, but do not promote responsible risk-taking or reasonable rates. Regulatory or legislative bodies must decide whether insurance regulation is the appropriate means to fulfil social goals. In nearly all jurisdictions where insurers are prevented from excluding specific categories of risk, that kind of insurance might not be available. For example, if individuals cannot be excluded from purchasing health insurance because they are HIV positive, insurers may opt to avoid selling any health insurance policies whatsoever in that jurisdiction. Usually there are statutes and regulations which do require that current actuarial tables are used and disclosure of the year and source of the tables derivation.

Business decisions

Most regulating entities accept that taking underwriting decisions is an integral part of the insurance business and, except for issuing guidelines banning certain influences on decision-taking, regulators are not involved. The prospective insured always retains the right to file a complaint, or bring legal action against an insurer, if they believe cover has been denied on discriminatory or arbitrary grounds. In addition, any given class of policyholder (whether general or long-term) is usually subjected to the same underwriting standards for similar policies. There should be no discrimination and no favouritism in the underwriting process.

The basis for this is that a company's underwriting procedures and standards are at the core of their insurance business and, in a strong economy, they must be able to act as competitively as possible. Their standards can be reviewed by a regulator during company examinations or, when considering a licence application.

B.5.3 Rates and tariffs

Statutory regulation or limits

In the life insurance industry, it is rare for rates to be established by regulation or by concerted action. This is partly because of the many variations in policies, interest rates and underwriting. The only restrictions widely found are that rates for specific policies must be identical for all purchasers after any adjustments to reflect underwriting issues.

On the other hand, it is common for non-life business rates and tariffs to be regulated, especially for compulsory insurance such as third-party automobile liability coverage. This is often the case in respect of specialized insurance such as flood or earthquake cover. Since these coverages can be either mandatory or linked to high risk occurrences, the view is often taken, that there must be some pricing control to protect both. Most insurers could not survive a 'price war' and most consumers would have no coverage if premiums were too high. In the long-term, natural disaster insurance is generally not a high profit area and, lately, insurers have suffered substantial losses from the frequent hurricanes, earthquakes and other natural disasters affecting our planet.

Prior approval

Prior approval of rates is no substitute for proper solvency monitoring. Some evolving jurisdictions start with tight controls which are gradually relaxed as the market becomes more competent. However, at all times a supervisor must have rules for measuring the financial condition of a company and estimating its future prospects.

Some governments do not set rates or tariffs but maintain the right to disapprove a specific rate either when established or when changed. Usually, increases or decreases in premiums need to be justified. Sometimes law courts take responsibility for approving rate changes when dealing with a bankruptcy or rehabilitation.

To increase premiums insurers usually need to show an economic justification. A decrease in premiums, must involve no harmful effect on the well-being of insurers or policyholders. The regulatory interest is not in profit levels but in the harm altered premiums could inflict on policyholders or insurers. A regulator can leave price setting to insurers and markets, but this practice requires strong, enforceable laws against cartels and monopolies plus strict solvency examinations and regulations. This need is greater for life and long-term products than for non-life products.

Independent pricing

Independent pricing involves leaving premium levels to be set by market forces. The market determines costs and there are no limits on profit margins for insurers. This can be dangerous when companies operate in growing and competitive industries because of the temptation to undercut competition even if it endangers the financial well-being of the company. This approach usually works only in developed markets with sound, stable economies and educated consumers.

B.5.4 Claims

Strict rules

Strict rules exist stipulating the time periods within which claims must be paid. These time frames are usually calculated from the day of receipt of the claim by an insurer. There are also likely to be statutory requirements relating to proof of claim as well as valid reasons for claim denial. The extent and complexity of the requirements vary between jurisdiction.

General guidelines

This option would not preclude some statutory recognition for guidelines for fairness and promptness in the payment of claims. It differs from the previous option in that guidelines are more likely to embody principles rather than specifics. More decisions are left to the discretion of an insurer.

In general, when dealing with claims, the rules or statutes should be formulated so as to offer redress to consumers for arbitrary decisions or delayed payments by insurers. Usually actions for payment would be initiated by consumer complaints which could lead to investigation and enforcement of penalties, if necessary, by a supervisor. Therefore, in selecting a framework for claim regulation, one perspective might be the ease with which such rules can best protect the rights of consumers and/or policyholders.

B.6 COMPANY STRUCTURE, CORPORATE GOVERNANCE AND INTERNAL CONTROL

B.6.1 Structure

Joint stock companies

Most insurance companies are either joint stock companies or mutuals. Joint stock companies may be publicly owned by large numbers of shareholders who have no day-to-day relationship with the company. The value of the shares fluctuate and depend on stock-market perceptions of the earnings of a company and the value of dividends due to its shareholders. Most policyholders are simply customers with no financial interests other than the benefits set out in their policies. Shareholders generally have no say or control in the management of a company-except for voting for the board of directors and the adoption of the annual report and accounts. However, most public companies are required by law to file regular reports with the appropriate regulatory authorities, indicating their financial status and any material changes in their operations. There are instances where policyholders also have a stake in the earnings of stock companies.

A joint stock company may also be privately owned with shares held by a relatively small group of individuals well known to each other. In this type of joint stock company, the shareholders also control the activities of the company and split the profits in the form of dividends. They may, or may not, be employed as managers of the company. In some jurisdictions there may be no filing requirements for a private company and, therefore, an insurance regulator must carefully monitor the activities of such a company and its owners.

A joint stock company may also be a wholly owned subsidiary of a holding company or of an insurance or other financial services company. The degree to which insurance companies may engage in other businesses, either directly or through affiliates, is paramount when considering the exact structure of the holding company. It should be noted that although most jurisdictions do not restrict the business of the parent or affiliates of an insurance company, some countries do. These restrictions might limit the ownership of an insurance company to another insurer or they might prohibit a bank from owning an insurer. Some countries, however, monitor the source of capital used to start an insurance subsidiary. They do this to ensure that shareholders have not borrowed its capital, thus endangering the company.

Although there are some sound reasons for these restrictions, many countries are eliminating them to encourage more open markets and free competition. That being the case, the source, independence and accessibility of capital within a joint stock life company should always concern an insurance supervisor. Most nations do not permit the same company to conduct both life and non-life businesses. In small markets this might not be realistic, but if it happens, the reserves for each line of business, should be carefully separated.

Mutuals

Mutual insurers have no shareholders. They are run for the benefit of policyholders. In the UK, policyholders are held jointly and severally liable for the debts of mutuals. Theoretically, policyholders are responsible for running mutuals through a board of directors or officers. Although policyholders have the opportunity (and the right) to vote for the directors or officers, this right is rarely exercised. Like shareholders, policyholders participate in the profits of the company

through dividends. These dividends often take the form of reduced premiums or bonuses. Policyholders cannot sell or transfer these rights because they usually become invalid when their policies expire.

Because there are no 'owners' of a mutual company, there can be less accountability. In some jurisdictions, there is no mandatory financial reporting to either the public or the shareholders. The only reporting required is to an insurance department. Because there is no stock to sell, mutuals are restricted when it comes to raising funds for expansion and growth. They must rely mostly on premiums and investment income surplus to claim payments. When investment income is high, a mutual does well; when it is low, cash raising options are limited. This has resulted in a number of mutuals converting to stock companies in jurisdictions which permit such changes.

The liability of directors and/or officers of mutuals varies from jurisdiction to jurisdiction. For example, in some countries they are jointly and severally liable for a mutual's acts. In others they are not.

Since there is no stock to be held, mutuals are usually unable to be subsidiaries, unless they are subsidiary to a mutual holding company. If part of a holding company structure, a mutual insurer must be the holding entity or must convert itself into a stock company. It is possible, however, for mutuals to merge in order to expand.

Holding companies -unregulated

It is common for regulators to only supervise an insurance company when it is held within a holding company structure. They have little or no control, or jurisdiction, over the business or management of a holding company or other non-insurance subsidiaries. The underlying principle is that non-insurance companies within a holding company structure are not the concern of insurance regulators unless there are negative effects on the solvency, or management, of the insurer. If negative consequences do result, this would be discovered during examination of the finances and reports of the insurance subsidiary. Any agreements between the insurer and other members of the holding company are to be expected to be arms' length transactions and would be subject to insurance department scrutiny. In jurisdictions in which subsidiaries are viewed as free-standing, independent entities, the assets of the holding company, or its affiliates, would not be available to the policyholders if the insurer becomes insolvent. However, the parent of a wholly owned insurance subsidiary might be expected to leave a deposit or guarantee on behalf of the subsidiary. If an insurer is to be sold, it is usual for an insurance regulator to require prior approval or, at least, to receive notification before the sale. After such notification, a supervisor can impose restrictions on the sale if he felt it was not in the best interests of policyholders. When mutuals are also holding companies, there are likely to be additional regulatory requirements.

Holding companies - regulated

In countries which limit the range of business an insurance company can conduct, there can be a perceived need to limit the range of businesses in which its holding company or non-insurance affiliate can engage. These limitations could prohibit an affiliate from entering the banking business or, on the other hand, require a parent or affiliate of an insurance company to engage in some other aspect of financial services. The intent is to prevent insurers from doing indirectly what they cannot do directly. This area is less pertinent to mutuals since their

position as an insurer will determine what may or may not be undertaken. Since mutuals must also be holding entities, an insurance supervisor will always have jurisdiction over the entire holding company system.

A developing market might wish to control the influence of non-insurers over its insurance industry which is a reason for placing restrictions on company systems. However, such restrictions run counter to a growing trend toward more open and independent markets. The ultimate decision on the role of holding companies, and their appropriate powers should take into account their standing in the economic and financial framework of a jurisdiction.

The IAIS Core Principles, Essential and Additional Criteria are shown in the following box.

B.6.2 Corporate governance (IAIS Core Principle 4)

It is desirable that standards be established in the jurisdictions which deal with corporate governance. Where the insurance supervisor has responsibility for setting requirements for corporate governance, the supervisor should set requirements with respect to:

- the roles and responsibilities of the board of directors;
- reliance on other supervisors for companies licensed in another jurisdiction; and
- the distinction between the standards to be met by companies incorporated in his jurisdiction and branch operations of companies incorporated in another jurisdiction.

Note: Insurers should be committed to achieving regulatory objectives and demonstrate a respect for the spirit and intent of the laws. The insurance supervisor requires that the level of observance be assessed regularly to ensure that regulatory requirements are fully met.

The criteria listed below may be governed in whole or part by the general corporate law of the jurisdiction, in which case the insurance supervisor's responsibilities will be addressed primarily towards verifying and enforcing observance of those requirements where responsibility for this does not reside elsewhere.

Essential Criteria

1. The insurance supervisor has the authority to require boards of directors to clearly set out their responsibilities towards acceptance of and commitment to the specific corporate governance principles for their undertaking.
2. The insurance supervisor has the authority to require boards or directors to clearly set out their strategic objectives.
3. The insurance supervisor has the authority to require boards of directors to set out the means of attaining those objectives and procedures for monitoring and evaluating their progress toward those objectives.
4. The insurance supervisor has the authority to require boards of directors to clearly set out the nomination and appointment procedures, structure, functions, re-elections and balance between executive and non-executive directors of the board in a transparent manner.

Continued . . .

Core Principle Continued . . .

5. The insurance supervisor has the authority to require boards of directors to clearly distinguish between the responsibilities, accountabilities, decision-making, interaction and cooperation of the board of directors, chairman, chief executive and management.
6. The insurance supervisor has the authority to require a clear division of responsibilities which will ensure a balance of power and authority, so that no one individual has unfettered powers of decision. Where the posts of chairman and chief executive are combined in one person, the insurance supervisor has the authority to verify that appropriate controls are in place to ensure that management is sufficiently accountable to the board of directors.
7. The insurance supervisor has the authority to require boards of directors to have in place and to monitor independent risk management functions related to the type of business undertaken.
8. The insurance supervisor has the authority to require boards of directors to have in place external audit functions, strong internal controls and applicable checks and balances.
9. The insurance supervisor has the authority to require boards of directors to have in place clear complaints procedures and to communicate them properly to their customers.

Additional Criteria

1. The insurance supervisor has the authority to require boards of directors to clearly set out policies regarding conflicts of interest, fair treatment of customers and information sharing with stakeholders.
2. The insurance supervisor has the authority to require boards of directors to have clear policies on private transactions, self-dealing, preferential treatment of favoured internal and external entities, covering trading losses and other inordinate trade practices of a non-arms length nature. The insurance supervisor has the authority to ensure that systems are in place to monitor and report deviations to an appropriate level of management.
3. The insurance supervisor has the authority to require boards of directors to ensure that they are not subject to undue influence from management or outside concerns.
4. The insurance supervisor has the authority to require boards of directors to make proper and full disclosure in their annual reports of their level of adherence to corporate governance principles and attainment of stated corporate objectives.
5. The insurance supervisor has the authority to require boards of directors to adopt a goal of improving customer awareness and knowledge.
6. The insurance supervisor has the authority to require boards of directors to create a functionary known as the compliance officer to oversee observance by the institution and its staff with relevant laws and required standards of business conduct, and to report to the board of directors at regular intervals.

Continued . . .

Core Principle Continued . . .

7. The insurance supervisor has the authority to require boards of directors to have in place a proper remuneration policy for directors and senior management, to review that policy periodically, and to disclose it to the insurance supervisor or to the public consistent with the applicable standards of the jurisdiction.

The IAIS Core Principles, Essential and Additional Criteria are shown in the following box.

B.6.3 Internal controls (IAIS Core Principle 5)

The insurance supervisor should be able to:

- review the internal controls that the board of directors and management approve and apply, and request strengthening of the controls where necessary; and
- require the board of directors to provide suitable prudential oversight, such as setting standards for underwriting risks and setting qualitative and quantitative standards for investment and liquidity management.

Essential Criteria

1. The insurance supervisor has the authority to review the internal controls that the board of directors and management approve and apply; where necessary the supervisor requests a strengthening of the controls. These controls should be adequate for the nature and scale of its business.
2. The insurance supervisor has the authority to require the board of directors to provide suitable prudential oversight, such as setting standards and monitoring controls for underwriting risks, valuation of technical provisions (policy liabilities), investment and liquidity management and reinsurance.
3. The insurance supervisor has the authority to require the board of directors to provide suitable oversight of market conduct activities such as setting standards and monitoring controls on fair treatment of customers; proper disclosure to customers of policy benefits, risks and responsibilities; conflicts of interest; handling of clients money; and separation of principal and agent activities.
4. The insurance supervisor has the authority to require internal controls to address issues of an organizational structure; ie of duties and responsibilities including clear delegation of authority, decision-making procedures, separation of critical functions (for example, new business, claims, reconciliation, risk management, accounting, audit and compliance).
5. The insurance supervisor has the authority to require internal controls address accounting procedures, reconciliation of accounts, control lists and information for management.
6. The insurance supervisor has the authority to require internal controls to address checks and balances; eg segregation of duties, cross-checking, dual control of assets, double signatures.
7. The insurance supervisor has the authority to require controls on safeguarding of assets and investments, including physical control.

Continued . . .

Core Principle Continued . . .

8. The insurance supervisor has the authority to require that the insurer has an ongoing audit function of a nature and scope appropriate to the nature and scale of the business. This includes ensuring compliance with all applicable policies and procedures and reviewing whether the insurer's policies, practices and controls remain sufficient and appropriate for its business. The insurance supervisor should determine whether the audit function:
 - has unfettered access to all the insurer's business lines and support departments;
 - has appropriate independence, including reporting lines to the board of directors and has status within the insurer to ensure that senior management reacts to and acts upon its recommendations;
 - has sufficient resources and staff that are suitably trained and have relevant experience to understand and evaluate the business they are auditing; and
 - employs a methodology that identifies the key risks run by the institution and allocates its resources accordingly.
9. The insurance supervisor has the authority to require that insurers have formal procedures to recognize potential suspicious transactions.
10. The insurance supervisor has the authority to require that insurers have established lines of communication both to management, law enforcement authorities and/or the insurance supervisor for the reporting of irregular and suspicious activities.

Additional Criteria

1. In those jurisdictions with a unicameral board structure (as opposed to a bicameral structure with a supervisory board and a management board), the insurance supervisor encourages the company to appoint experienced non-executive directors to the board.
2. The insurance supervisor encourages the establishment of an internal audit function that reports to an Audit Committee of the board.
3. The insurance supervisor has access to reports of the internal audit function.
4. In those jurisdictions with a unicameral board structure, the insurance supervisor has the authority to require the Audit Committee to be composed of a majority of experienced non-executive directors.
5. The insurance supervisor requires actuarial reporting where called for by applicable law or by the nature of the insurer's operations, and where appropriate encourages the appointment of an actuary reporting directly to the board or directors.

SUMMARY

Module B focuses on some of the major responsibilities of supervisors: insurer licensing and operations. It offers choices for licensing and describes various statutory and supervisory standards which have been used to control the licensing of companies and branches. Although it recognizes that a regulator can establish these standards either by supervision or by seeking statutory change, it also recognizes that choice will be influenced by the political history of the jurisdiction. Attention is paid to the role of foreign establishment and the manner in which such establishment is to be supervised.

In reviewing the operations of an insurer, Module B discusses the roles of underwriters and supervisors in monitoring and supervising underwriting procedures and guidelines. Attention is given to the appropriate structure and management of an insurer and the role a supervisor might play in supervising and assisting an insurer in making necessary operational choices. Differing views on the advisability of supervising products and tariffs are also presented.

Module B intends to outline the role and authority of a supervisor when dealing with the issues studied. Module C deals more specifically with solvency regulation and the statutory tools available to supervisors to help them perform their duties.

MODULE C

FINANCIAL STABILITY

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FINANCIAL STABILITY

INTRODUCTION

The solvency of an insurer is the key indicator of its financial strength and, therefore, its ability to pay claims. An insurer's solvency depends on there being an excess of admissible assets over liabilities. Most jurisdictions demand that insurers should have a minimum margin of solvency to meet fluctuations in forecast expenses (including claims) and to provide a surplus of free funds for unforeseen contingencies.

Many insurers use reinsurance to minimize excessive exposure to catastrophe and to improve their solvency positions. In many jurisdictions insurance supervisors use experienced professionals (eg actuaries and auditors) to assist in more accurately measuring insurer solvency and their corporate assets and liabilities. The values of the latter are key elements for supervisors when inspecting and verifying an insurer's financial situation.

Financial tests

A company's annual report and accounts provide core financial data. The information is grouped into four categories:

1. Assets,
2. Liabilities and surplus ('free reserves') and liquidity,
3. Income (investment and premium),
4. Expenses.

Some insurers account for long-tail business on a fund basis spanning one to seven years and aggregating all underwriting income and expenses in an annual fund for each underwriting year until a more accurate picture of the reserves is available. When supervising this method of accounting, it is important that an annual assessment of reserves is made to prove the adequacy of these funds.

It is also important to look at the historic trend of the value of financial ratios. This helps detect possible solvency problems.

Once the data is gathered, it is reviewed to ascertain whether adequate reserving has taken place, that available capital is related to anticipated risk and that all financial ratios are sufficient to enable the company to operate without financial difficulty. What follows are abbreviated descriptions of some of the standards that help jurisdictions decide which standards, when established, would best meet their particular needs.

IRIS (USA)

In the USA, the NAIC (National Association for Insurance Commissioners) has established IRIS (Insurance Regulatory Information System) ratios which help identify problem companies. These have two phases:

1. Statistical phase during which key financial ratio results are generated, and an
2. Analytical phase during which annual statements and financial ratios are reviewed.

There are twelve ratios for life companies and eleven for non-life insurers. Failing more than three ratios can trigger a closer examination and review.

THE SUPERVISORY LADDER; RISK-BASED SUPERVISION AND RISK BASED CAPITAL (RBC)

The concept of the risk-based approach to supervision is that risk should be reduced in higher risk areas before problems arise. This contrasts with the traditional supervisory

approach of looking for problems and then attempting to deal with them. A major problem with the latter is that in many countries experience has demonstrated that when problems arise sometimes it is too late for remedies and companies will fail. In addition, looking for problems implies a need to investigate almost every aspect of a company's operations which requires substantial resources. On the other hand, risk-based supervision identifies areas of high risk. By focusing only on those areas, fewer resources are needed.

When employing a risk-based approach, supervisors should adopt a consistent approach when assessing risk. The supervisory response should be consistent from one insurer to another and from one situation to another. This is perhaps more difficult for developing country supervisors because they are often chronically short of well-trained staff and staff turnover may be high.

The supervisory ladder is an approach which will:

1. Permit supervisory staff to feel comfortable that their recommendations and actions are reasonably consistent over time and from one situation to another,
2. Give a supervisor and a government confidence that a supervisor's actions are in accordance with government policy, and will
3. Enable companies to know the strength of the supervisory response that can be expected in various situations and to govern themselves accordingly (ie no 'surprises' from supervisors).

The latter means that insurers should have access to supervisory ladders so that they can benefit from this information.

The supervisory ladder is merely a matrix approach, which for each institution identifies several levels of company risk across a number of different risk assessment categories, using and assessing different areas such as on-site inspections, financial analysis, reinsurance, capital adequacy and market intelligence. In keeping with our earlier terminology, these risk levels constitute the broad categories of risk profiles which supervisors need to identify in respect of each company.

An example of the supervisory ladder can be found following this section.

For the purpose of illustration, let us assume that we will have four levels of risk, ranging from Level 1, which is very low risk, to Level 4, which is extremely high risk, probably reserved for companies which are nearly insolvent.

For a typical Level 1 company, looking at the finances, a supervisor might expect to see not more than one early warning outside the normal test range. In addition, there would probably have been profitable operations for several years, a stable pattern of reasonable growth and with all other financial indicators in the 'healthy' range. On-site inspectors would report that the company has highly competent management, that the financial controls are well thought out and adhered to, that products are well-designed and properly priced, that investment strategies are sound, and so on. There would be no information from other sources to suggest anything other than a very sound institution.

At Level 2 a supervisor would begin to see information that could give rise to serious problems for the insurer if they are not solved. From a financial analysis, a supervisor might expect to see a company that is perhaps outside the normal range on, say, between two and five early warning tests. A supervisor's financial analysts may also be noticing that some of the trends in basic financial variables are showing adverse development. The on-site inspectors may be reporting problems in the internal control systems, which they consider sufficiently important to raise with the company. The company may be showing a worrisome trend in its loss and/or expense ratio or some investments may be questioned by the inspectors with regard to their appropriateness for the company, and

so on. So, while there are no loud alarm bells going off, the company is not free from supervisory concerns.

At Level 3 a supervisor begins to see more ratios moving out of line within a company, more serious profitability concerns and so on. But, by now, the concerns will have become quite significant. A supervisor might think that if no action is taken, the company could move to Level 4. That is, it could face insolvency within the next year, or less. Therefore, at Level 3 strong supervisory measures are required to deal with impending problems.

A supervisor should be able to describe the symptoms expected to be found within a company at each risk level.

The next step is to outline (in a similar fashion) what actions should be considered by a supervisor when confronted by a company at a particular risk level. For example, for a company at Level 2, one action might be to write to the company requesting it to outline its plan for dealing with the problems that have been noted. Another option might be to have the company file some additional financial information so as to keep the supervisor fully informed of developments. A third option might be to schedule the company for a somewhat earlier inspection than would otherwise be the case. For a company at Level 3, a supervisor might want to meet the board of directors to explain the seriousness of the problem. He could limit the amount of business the company is allowed to write, or he could introduce other restrictions on its operations or order a detailed business plan from the insurer setting out its strategy and time lines for dealing with the problems, within close oversight by the supervisor, and so on.

The text accompanying the supervisory ladder should make it clear that a supervisor's hands are not tied by the supervisory responses listed therein, because circumstances could arise where other options, not listed in the supervisory ladder options, could become the response of choice. If the supervisory ladder options have been carefully spelled out, this should be a rare. The text should also make it clear that supervisors can, depending on circumstances, take all or any combination of the options listed for a particular risk level. Although early warning tests are extremely useful as general indicators, each situation has to be assessed on its own merits.

The various components of the supervisory ladder matrix can be made as detailed as a supervisor wishes in terms of outlining the symptoms of problems and the supervisory responses that will be taken.

The supervisory ladder allows the whole process of risk level consideration and the choice of appropriate supervisory responses, to take place in an atmosphere of calm consideration and discussion. This is unlikely to happen when insurers meet emergency situations.

The supervisory ladder also enables politicians to consider appropriate supervisory responses to meet different risk levels existing before a total financial collapse. In this way supervisors can feel confident that corrective proposals are understood at government level and will be supported when they are taken.

Supervisors can make a supervisory ladder serve as a focus for almost all supervisory procedures. This approach has been taken in some countries. In other jurisdictions, supervisory ladders are not developed to the same detailed extent and are considered more as general guidelines to be observed by regulated companies. In all cases, however, the ladders serve to ensure that there is a consistent approach in dealing with company problems.

The Supervisory Ladder

Risk Level	Examples of Observed Risks				Examples of Regulatory Response for Risk Level
	Financial Analysis	On-Site Inspections	Auditor and Actuary	Market Intelligence	
Level 4 Company not viable, insolvency imminent	Capital and surplus on real value basis almost at zero level ...	Senior management and directors unable to realize the magnitude of the problems facing the company. Some directors may be resigning. Financial information bears little relation to reality. Major transactions with related companies	Unable to sign financial statements or actuarial certification.	Media speculation that company won't survive. Public cancelling policies. Brokers switching to other carriers.	Institute procedures for rehabilitation or liquidation.
Level 3 Future financial viability in serious doubt	More than 10 key ratios (of total of 20) outside of normal range. Financial trends have diverged sharply from industry norms. Delays in provision of financial information. Analysts are seeing many transactions with affiliated corporations. Premium volume too high for current level of capital and surplus	Serious lack of financial controls, financial information considered unreliable, understating of reserves, very high expenses, actuarial assumptions far from reality of current situation. Asset values overstated, especially real estate holdings. Quality of investment portfolio poor. Significant transactions with affiliated corporations ...	Increase in number of concerns expressed in management letter, serious resistance by company to dealing with problems noted by auditor and actuary. Auditor may agree to share some concerns with regulator on "off the record basis" ...	Change in rating by rating organization, disputes with reinsurers, industry rumours being noted by regulator, increase in complaints from public over slow payment of claims or claims handling procedures.	Senior regulatory officials meet with management and board of directors of company and external auditor of company to outline concerns and discuss remedial actions. Company must provide acceptable business plan to regulator reflecting appropriate strategy and remedial measures that will improve the company's position within a specified time frame. Limitations on company's licence authorization ...
Level 2 Emerging risk to financial viability of company	Between 6 and 9 ratios outside of normal range, unsatisfactory trend in key financial parameters...	Poor earnings, operating losses or deterioration in the profitability of the company's business. Less than satisfactory management responses to expressed concerns. Deficiencies in procedures. Growing concern by inspectors over need for improved financial controls. Lack of planning. Significant, sudden changes in mix of business; move to high risk investment policies; difficulty in assessing reinsurance or loss of key reinsurers.	Some important concerns being expressed in management letter. Company responses showing defensiveness and some lack of co-operation ...		Company notified of concerns and requested to take measures to rectify situation. Monitoring of remedial actions. Requests for additional information and/or follow-up inspections. Regulator may require external review of company's actuarial methods and assumptions ...
Level 1 No major problems, normal activities	Fewer than 5 key ratios outside of normal range.	Inspectors report that management team is strong, appear to have well thought out business strategy, good financial controls, conservative investment policy. Profitable operations.	Routine reports, no significant concerns expressed in management letter.		

The foregoing has been provided to several jurisdictions in Latin America as a schematic example of the supervisory ladder concept. Each cell of the matrix can be expanded into considerably more detail. An additional risk level can also be added to provide more detail. If a supervisory organization has other divisions, such as reinsurance analysis and actuarial, they can be represented by adding new columns.

Risk-based capital requirements (sometimes referred to as 'eligible asset regulations' in other English speaking jurisdictions) define formulae for capital levels based on company risk. These formulae differ for life and non-life companies and are directly related to matching investment risks against policy obligations. These rules mandate a range of specific regulatory actions for various levels of capital deficiency viz:

1. No action,
2. Submission of a comprehensive financial plan by the insurer,
3. In-depth examination of the insurance company operations and financials,
4. Outright control of the company assumed by the regulator.

A major concern facing most supervisors today is the financial well-being of insurance companies under their jurisdiction. Supervisors must balance the need for insurers to maintain their solvency with their need to operate independently and competitively. Financial examinations are a key tool enabling supervisors to meet this challenge. However, there are options both as to the content of the financial examinations and the way in which they are administered. There are also peripheral issues such as - who conducts the exams, how often they are conducted and how is the cost to be budgeted and reimbursed? (The last issue was considered in Module A) There are also various formulae and check-lists, any one of which may suit different jurisdictions, and which have been devised to assist supervisors in recognizing potential problems as early as possible. Some of these are briefly reviewed in this module. More detailed information can be obtained by contacting the jurisdiction which utilizes these particular mechanisms.

Keeping an eye on an insurer's solvency is arguably the prime goal of insurance supervisors and, hopefully, of every insurer as well. The larger the insurance market, and the greater the number of insurers, the more standardized the rules must be. In a very small market, where the players are better known to each other, standard requirements may be replaced or accompanied by considerations on a case-by-case basis. Although various tests and ratios are offered as means of monitoring solvency and giving warnings of possible financial problems ahead, it is important to remember that, ultimately, it is the supervisor who must oversee the use of those criteria. He must be able to exercise control and enforce statutes. Thus, statutes must be drafted with the used for enforcement in mind.

This module focuses on the general area of solvency, its component parts, and appropriate means of monitoring and assuring the financial stability of insurers. It will also look at annual statements which are universally required from insurers by supervisors. The discussion includes the role of actuaries, methods of accounting, financial tests and warning signs which assist supervisors to determine the financial and operating stability of particular companies. The important subject of on-site examination warrants more exhaustive review.

C.1 CAPITAL ADEQUACY AND SOLVENCY

The IAIS Core Principles, Essential and Additional Criteria are shown in the following box.

C.1.1 Capital adequacy and solvency (IAIS Core Principle 8)

The requirements regarding the capital to be maintained by companies which are licensed or seek a licence in the jurisdiction, should be clearly defined and should address the minimum levels of capital or the levels of deposits that should be maintained. Capital adequacy requirements should reflect the size, complexity, and business risks of the company in the jurisdiction.

Essential Criteria

1. Legal provisions address the three components of solvency, ie the ability of the insurance company to fulfil its commitments at any time:
 - the level of technical provisions (policy liabilities);
 - the adequate coverage of technical provisions (policy liabilities) by assets;
 - an additional buffer (required minimum solvency margins - minimum capital adequacy requirements).
2. The main control levels of these components ensure, with a very high probability, that the insurer is able to meet its obligations at any time.
3. The insurance supervisor has the authority to monitor these three components.
4. The required minimum solvency margins (capital) depends on the size, complexity and the business risks of the insurance company.
5. A minimum amount of capital, depending on the types of business the insurer is entitled to write and staying in line with developing cost and price, is required for all insurance companies.
6. The components of solvency margins, ie capital elements which are considered as free capital for regulatory purposes, are clearly defined.
7. At given time intervals, the company assesses the amount of its available solvency margins (capital).
8. Where the capital available reaches or falls below one or more control levels, the insurance supervisor has the authority to intervene or impose restrictions.
9. The insurance supervisor has the authority to intervene to require an insurance company to hold capital at a higher level than the required minimum margin where circumstances exist to justify such an action.
10. The inflation of supervisory capital through double/multiple gearing or other financing techniques in an 'insurance group' should be eliminated. The structure of the 'insurance group' should be transparent.

Additional Criteria

1. The insurance supervisor has the authority to require that the minimum amount of capital be covered by unencumbered assets (ie not pledged assets). If exceptions are permitted, they are closely monitored by the insurance supervisor.
2. The insurance supervisor is entitled to disclose information - case by case or in aggregated form - to other insurance supervisors about the solvency status of the insurers under its supervision.

C.2 ASSETS AND DERIVATIVES

The IAIS Core Principles, Essential and Additional Criteria are shown in the following box.

C.2.1 Assets (IAIS Core Principle 6)

Standards should be established with respect to the assets of companies licensed to operate in the jurisdiction. Where insurance supervisors have the authority to establish the standards, these should apply at least to an amount of assets equal to the total of the technical provisions, and should address:

- **diversification by type;**
- **any limits, or restrictions, on the amount that may be held in financial instruments, property, and receivables;**
- **the basis for valuing assets which are included in the financial reports;**
- **the safekeeping of assets;**
- **appropriate matching of assets and liabilities, and**
- **liquidity.**

Note: The Supervisory Standard on Asset Management by Insurance Companies should be referred to in order to obtain a full view of asset management control.

It is not intended through these criteria that an insurance supervisor should advise on the detailed formulation of an insurance company's asset management policy and internal risk control methodology; this should be the responsibility of the board of directors.

Essential Criteria

1. Legal provisions on asset management are in place. These legal provisions may define the following: mixture and diversification by type; any limits, or restrictions on the amount that may be held in financial instruments, property, and receivables; the basis for valuing assets which are included in the financial reports; the safekeeping of assets; appropriate matching of assets and liabilities; and liquidity.
2. Assets are valued on a basis prescribed by or acceptable to the insurance supervisor.
3. The insurance supervisor has the authority to require insurers to have in place an overall strategic investment policy, formulated and approved by the board of directors, that addresses the following main elements:
 - the determination of the strategic asset allocation, that is, the long-term asset mix over the main investment categories;
 - the establishment of limits for the allocation of assets by geographical area, markets, sectors, counterparties and currency;
 - the extent to which the holding of some types of assets is ruled out or restricted, for example where the disposal of the asset could be difficult due to the illiquidity of the market or where independent (ie external) verification of pricing is not available;
 - under what conditions the company can pledge or lend assets;

Continued . . .

Core Principle Continued

- an overall policy on the use of financial derivatives or of structured products that have the economic effect of derivatives or the explicit exclusion of the use of such products or of certain types of such products; and
 - the framework of accountability for all asset transactions.
4. The insurance supervisor requires insurers to have in place comprehensive risk management policies and systems capable of promptly identifying, measuring, reporting and controlling the risks associated with investment activities that might affect the coverage of technical provisions (policy liabilities) and/or solvency margins (capital). These main risks are:
- market risk (adverse movements in, for example, stocks, bonds and exchange rates);
 - credit risk (counterparty failure);
 - liquidity risk (inability to unwind a position at any price near fair market value);
 - operational risk (system/internal control failure);
 - legal risk; and
 - safe keeping of assets.
5. The insurance supervisor checks that insurers have in place adequate internal controls to ensure that assets are managed in accordance with the overall investment policy, and the legal and regulatory requirements. These controls should ensure that investment procedures are documented and properly overseen, and that the functions responsible for measuring, monitoring, settling and controlling asset transactions are distinct from the front office functions.
6. The insurance supervisor requires that oversight of, and clear management accountability for, an insurer's investment policies and procedures remains ultimately with the board of directors, regardless of the extent to which associated activities and functions are delegated or outsourced.
7. The insurance supervisor checks that insurers have in place rigorous audit procedures that include full coverage of their investment activities to ensure the timely identification of internal control weaknesses and operating system deficiencies. If the audit is performed internally it should be independent.

Additional Criteria

1. The insurance supervisor checks that insurers have in place effective procedures for monitoring and managing their asset/liability position to ensure that their investment activities and asset positions are appropriate to their liability profiles.
2. The insurance supervisor checks that the board of directors of an insurer reviews the adequacy of its overall investment policy at least annually in the light of the company's activities, and its overall risk tolerance, long-term risk requirements and solvency position.
3. The insurance supervisor encourages insurers to undertake regular resilience testing for a range of market scenarios and changing investment and operating conditions in order to assess the appropriateness of asset allocation limits

The IAIS Core Principles, Essential and Additional Criteria are shown in the following box.

C.2.2 Derivatives and ‘Off-Balance Sheet’ Items (IAIS Core Principle 9)

This section applies in jurisdictions where derivatives or other items are not reported on the balance sheet and are thus not subject to the reporting requirements established for financial statements.

The insurance supervisor should be able to set requirements with respect to the use of financial instruments that may not form a part of the financial report of a company licensed in the jurisdiction. In setting these requirements, the insurance supervisor should address:

- restrictions in the use of derivatives and other off-balance sheet items;
- disclosure requirements for derivatives and other off-balance sheet items; and
- the establishment of adequate internal controls and monitoring of derivative positions.

Note: The Supervisory Standard on Derivatives should be referred to in order to obtain a full overview of the control of derivatives.

Essential Criteria*

1. There are requirements in place that address restrictions in the use of derivatives and other off-balance sheet items.
2. Disclosure requirements should be established for derivatives and other off-balance sheet items.
3. The insurance supervisor requires insurers using derivatives to have in place an appropriate policy for their use, formulated and approved by the board of directors. This policy should be consistent with the company’s activities, its overall strategic investment policy and asset/liability management strategy, and its risk tolerance. It addresses the following main elements:
 - the purposes for which derivatives can be used;
 - It is not intended through these criteria that a supervisor should advise on the detailed formulation of an insurance company’s asset management policy and internal risk control methodology; this should be the responsibility of the Board of Directors.
 - the establishment of appropriately structured exposure limits for derivatives taking into account the purpose of their use and the uncertainty caused by market, credit, liquidity, cash flow, operations and legal risk;

* It is not intended through these criteria that a supervisor should advise on the detailed formulation of an insurance company’s asset management policy and internal risk control methodology; this should be the responsibility of the Board of Directors.

Continued . . .

Core Principles Continued

- the extent to which the holding of some types of derivatives is restricted or not authorised; for example, where the potential exposure cannot be reliably measured, the closing out or disposal of the derivative could be difficult due to its lack of marketability (as may be the case with over-the-counter instruments) or the illiquidity of the market, or where independent (ie external) verification of pricing is not available; and
 - the delineation of lines of responsibility and a framework of accountability for derivatives functions.
4. The insurance supervisor requires insurers to have in place comprehensive systems, forming part of their wider investment risk management systems, capable of identifying, measuring, controlling, and reporting (both internally and to the supervisor) the risks from derivatives activities. These systems ensure that the risks arising from all derivatives transactions undertaken by the insurer can be:
 - analysed and monitored individually and in aggregate; and
 - monitored and managed in an integrated manner with similar risks arising from non-derivatives activities so that exposures can be regularly assessed on a consolidated basis.
 5. The insurance supervisor checks that the insurers have in place adequate internal controls to ensure that derivatives activities are properly overseen and that transactions have been entered into only in accordance with the insurer's approved policies and procedures, and legal and regulatory requirements. These controls ensure that the functions responsible for measuring, monitoring, settling and controlling derivatives transactions are distinct from the front office functions.
 6. The insurance supervisor requires that the board of directors of an insurer ensures that the company has the appropriate capability to verify pricing independently where the use of 'over-the-counter' derivatives is permitted under the company's policy.
 7. The insurance supervisor checks that insurers have in place rigorous audit procedures that include coverage of their derivatives activities to ensure the timely identification of internal control weaknesses and operating system deficiencies. If the audit is performed internally it should be independent.

Additional Criteria

1. The insurance supervisor checks that the board of directors of an insurer reviews the adequacy of its derivatives policies and procedures at least annually in the light of the company's activities, its overall risk tolerance, and market conditions.
2. The insurance supervisor requires the board of directors of an insurer to satisfy themselves that collectively the board has sufficient expertise to understand the important issues related to the use of derivatives, and that all individuals conducting and monitoring derivatives activities are suitably qualified and competent.

The above criteria of transparent and structure decision-making procedures of policy setting, execution, monitoring, reporting and control apply equally to financial transactions that are not derivatives transactions but which may be included in some jurisdictions as 'off-balance sheet' items.

The supervisory standard on derivatives is contained in Appendix 7.

C.2.3 Investment regulation

Prudent investor standard

The prudent investor standard provides that as long as investments are made in a fashion reasonably intended to meet an investor's objectives, there is no need to define the various components of an investment portfolio. The provision assumes that those managing the investment portfolio are responsible, knowledgeable investment managers and, as such, should be allowed to use their discretion. In any event, the quantitative and qualitative requirements of the provision should serve to monitor the level of investment growth.

This standard should be adequate for assets set aside to provide a surplus above solvency margins and for investment in non-admitted assets. However, if it is to be the standard for the investment of reserves, there is potential for significant difficulty in the fluctuations and volatility of today's markets. Highly experienced investment managers and tight regulations as to the amount of surplus and reserves needed would certainly need to accompany an investment regulatory scheme which provided no definition of the composition of the investment portfolio.

Supervisors should expect that insurers will establish proper investment policies and that the performance of their investments will be monitored. At the minimum, the provision's objects should be the safety of investments, the yields on investments and liquidity, bearing in mind the need to match assets against liabilities ie ensuring assets can be converted into sufficient cash when liabilities fall due for payment.

Quantitative and qualitative limitations

By establishing categories of investment, and by limiting the percentage of assets which can be invested in each category, investment guidance can be established without inhibiting the independence of insurers. Eligible assets (termed 'risk-based' capital requirements in the USA - not to be confused with Risk-Based Capital Regulations which relate different margins of solvency to different types of risk or classes of business) are preferred assets with high worth to reserve funds.

The practice of offering statutory guidelines for the category and percent of investment gives a certain amount of flexibility to an insurer when reassuring a regulator that there is enough diversity to protect against a drastic change in one area. For example, if an investment portfolio includes only limited real estate assets then a company's reserves are only slightly affected by marked changes in the value of real estate. When an insurer has met all his statutory requirements for capital, surplus, and reserves, additional investments can be permitted outside the guidelines. These investments are known as non-admitted or non-approved assets.

To make allowances for market fluctuations, some jurisdictions permit a 'hedging' technique, under restricted conditions, to allow their insurers greater flexibility. Others, which permit policies to be written in currencies other than the national currency, either permit reserves backing those policies to be invested in the currency of the policy or permit hedging against currency fluctuation. Currency considerations are extremely specialized and are influenced by the goals a jurisdiction wishes to achieve by attracting foreign investment, keeping it, and, in some instances, converting to a hard

or 'universal' currency. The geographical spread of investments and currencies is an important factor in ensuring the security of investments in many jurisdictions.

C.3 LIABILITIES

The IAIS Core Principles, Essential and Additional Criteria are shown in the following box.

C.3.1 Liabilities (IAIS Core Principle 7)

Insurance supervisors should establish standards with respect to the liabilities of companies licensed to operate in their jurisdiction. In developing the standards, the insurance supervisor should consider:

- **what is to be included as a liability of the company, for example, claims incurred but not paid, claims incurred but not reported, amounts owed to others, amounts owed that are in dispute, premiums received in advance, as well as the provision for policy liabilities or technical provisions that may be set by an actuary;**
- **the standards for establishing policy liabilities or technical provisions; and**
- **the amount of credit allowed to reduce liabilities for amounts recoverable under reinsurance arrangements with a given reinsurer, making provision for the ultimate collectability.**

Essential Criteria

1. Legal provisions are in place for establishing technical provisions (policy liabilities) and other liabilities based on sound accounting and actuarial principles.
2. The insurance supervisor has the authority to prescribe standards for establishing technical provisions (policy liabilities) and other liabilities.
3. The insurance supervisor has the authority to:
 - check the sufficiency of the technical provisions (policy liabilities) which at all times are such that the insurance company can meet any estimated insurance liabilities as they fall due; and
 - require these provisions (liabilities) to be increased if necessary.
4. The insurance supervisor assesses the adequacy of the technical provision (policy liabilities) as deemed necessary through on-site and off-site inspections.
5. When the insurance company has reinsured part of its risks, the insurance supervisor:
 - has the authority to stipulate general limits for the valuation of the amounts recoverable under reinsurance arrangements with a given reinsurer, taking into account the ultimate collectability;
 - has the authority to stipulate sound accounting principles for the booking of the amounts recoverable under reinsurance arrangements; and
 - may allow the reduction of technical provisions (policy liabilities) for amounts recoverable under reinsurance arrangements. In that case, the amount recoverable is disclosed in the financial statement of the insurer by respective gross and net figures shown in the accounts.

Additional Criteria

1. The insurance supervisor has the power to intervene against a specific reinsurance arrangement if the reinsurance conditions are not suitable with respect to the insured risks, the premiums which are ceded or the suitability of the reinsurance company.

C.3.2 Technical provisions / reserves

In addition to a capital test for solvency, most countries have instituted reserve requirements which are directly linked to the policy obligations of an insurer. These technical reserves are calculated to cover the contractual obligations to policyholders and other beneficiaries. These reserve requirements differ for life and non-life insurers.

Life: mathematical reserves

Mathematical reserves are designed as safeguards against situations in which risks increase over time while the value of unearned premiums remain constant. Regulations related to these reserves are often stringent because of the large savings' element managed for policyholders by life insurers acting as trustees. Usually mathematical reserves are reviewed and evaluated by qualified actuaries employed by both insurers and supervisors. Some supervisors retain external actuarial consultants to perform these tasks.

Non-life: premium reserves

Non-life premiums are usually charged in respect of cover for one year, but the year need not correspond with the fiscal year of the insurance industry or the individual insurer. Thus, a particular risk might not have expired when an annual report is prepared and the premium reserve will only cover the part of the premium not earned until the following financial or fiscal year. Such reserves are calculated either on a contract-by-contract basis or by a statistical method based on experience, grouping and samplings.

Outstanding claim reserves

These are established to cover known and/or reported claims which remain unsettled at the close of a reporting period. Such reserves eliminate the risk of an insurer deliberately delaying claim payments to ensuring the necessary reserves still appear in some form on quarterly or annual reports. This prevents erroneous overvaluation of an insurer's capital and surplus.

Claim reserves should also include a provision for claims incurred but not reported (IBNRs), especially in the case of long-tail business (casualty or liability classes). These are usually determined by actuarial techniques.

Other reserves

Countries vary in their requirements and might mandate reserves to be established for any unforeseen contingency resulting in a liability to pay large and unexpected claims which might adversely affect an insurer's financial stability. The less experienced an industry is, the greater the need for such reserves. Sufficient reserves should be put aside to meet claims for catastrophic occurrences such as earthquakes or other natural disasters.

C.4 REINSURANCE

Introduction

Most insurance companies rely to some extent on reinsurance. Reinsurance, involves the transfer of all or part of a risk from the original insurer to another insurer or reinsurer and can serve a number of purposes, particularly in developing markets.

1. For companies with low and sometimes inadequate capital, reinsurance may provide a valuable substitute for additional capital thereby increasing an insurer's ability to take on larger values of risk.
2. It can support a new, growing company by relieving it of a proportion of its direct risk, thereby increasing its overall capacity to take on new business.
3. It can enable a parent or joint venture partner to receive income by providing reinsurance to the subsidiary or joint venture company.
4. It may be used to facilitate repatriation of profits to a foreign parent investing in a country where such repatriation might otherwise be difficult.
5. If reinsurance is mandatory, and is restricted to a national company, then premium income may be invested within the country.
6. It can support an insurer's capital base by taking some of the liabilities from its balance sheet and reducing its net premium income; reinsurance can help insurers meet statutory requirements.

Reinsurance is usually most advantageous for new companies by allowing them to underwrite sufficient business to provide legitimacy as a competitor without an excessive strain on limited capital. Using well respected reinsurers can also give access to experienced underwriting. Because reinsurance is frequently relied upon by newer companies, a regulatory authority should always request a copy of their reinsurance programs. In regulating and supervising such programmes there are two questions which must be considered.

1. To what degree should a supervisory authority regulate the use of reinsurance?
2. To what degree should it regulate reinsurance companies?

C.4.1 Supervisory insurance ceded

Mandated reinsurance

It is common for a jurisdiction's insurance law to require an insurance company to reinsure a stipulated percentage of risk. Sometimes this is only required in the case of companies in their first few years of business operation. However, in some jurisdictions this is a perpetual requirement.

By making reinsurance mandatory, not only are risks reduced for a new company, but it can benefit by having access to underwriting advice from a company which is likely to be more experienced. Frequently regulations require that mandatory reinsurance is placed in an unaffiliated company. This can create problems in jurisdictions that do not have many reinsurers, or where a parent company is using reinsurance as a means of maintaining control over a subsidiary's underwriting, premiums and profits. This can be regulated by requiring that reinsurance is spread with no more than a stipulated amount being placed in any single company - including the parent.

In jurisdictions where reinsurance is mandatory, supervisors will invariably oversee reinsurance contracts even when insurers do not need advance approval to reinsure. Even if prior approval is not necessary, the reinsurance arrangements should be reviewed.

Oversight of reinsurance

Some jurisdictions prefer to exclude reinsurance from insurance statutes and instead review reinsurance programmes and contracts on a case-by-case basis. Generally, there is still a requirement for a newly formed company to use a reinsurer, although this might be because of a regulation rather than a statute. It is nearly always the case that programmes of reinsurance need prior approval from a supervisor. Option two still allows a supervisor to be involved in the reinsurance they must put into place at the time of licensing and on their annual renewal and the supervisor should be informed of any changes in a company's reinsurance programme.

Prior approval for such changes might, or might not, be required. Sometimes insurers and reinsurers are to have a maximum retention for a single risk. This can be expressed as a percentage of capital.

Initial review

Jurisdictions with well-established insurers might leave approval of reinsurance programmes to regulation rather than statute. Generally this involves a supervisor requiring some reinsurance for a new company while closely examining the programmes and contracts involved as part of the licence application procedure. Whichever method a supervisor selects, limits can still be placed on reinsurance for nonaffiliated companies and can also be placed on the amount of risk passed on to any single reinsurer. Such limitations are more likely to be imposed on a case-by-case basis using regulations rather than statutes.

C.4.2 Licensing reinsurers

National reinsurance company

Some countries still maintain state or nationally-owned reinsurance companies which handle all or most of the reinsurance in those countries. Not only does this hamper free market activity, it also limits the attractiveness of the market to outside investors. Such a monopolistic system makes it more difficult to rely on reinsurers to perform underwriting oversight responsibilities for insurers and could prevent them from selecting a reinsurance programme which would better suit their particular needs. This becomes a significant impediment for insurers hoping to do global business or for a branch or subsidiary of a foreign-owned company. Member jurisdictions of the WTO may keep their national reinsurance companies but they are obliged to compete with other reinsurers. Obligatory reinsurance with a single company is no longer allowed leaving insurers to choose reinsurers.

Required licensing

Some jurisdictions require that reinsurers are licensed in the same manner as insurers although, if a company limits its business to reinsurance, the capital requirements might be different. The nature and type of supervisory oversight might also differ from that applied to direct insurers, but the underlying criteria of strong reserves, adequate capital and fit and proper management still apply.

The requirement that reinsurers must be licensed is both compatible with either mandated or voluntary reinsurance. Some special circumstances might be written into a statute when, or if, a reinsurer is a controlling entity of an insurance company under review. This would not be an issue where reinsurance can only be ceded to an unaffiliated party.

In jurisdictions that require a percentage of premiums to be reinsured, an alternative might be to require only that the mandated reinsurance be placed with an admitted insurer.

Non-admitted reinsurers

Some jurisdictions, particularly those which do not mandate the placing of reinsurance, permit non-admitted reinsurers in the reinsurance market. However, this does not necessarily mean that all-comers can issue reinsurance. It is common to find that a regulatory authority, after investigation, has compiled a list of acceptable reinsurers who, although not licensed or admitted in that jurisdiction, are deemed financially stable and fit to issue reinsurance to the country's domestic insurers.

It is important to note that reinsurance is a complex subject and a supervisory authority must be knowledgeable about the many roles it can serve in stabilizing insurance businesses in a developing market. Reinsurance, used prudently, can provide an excellent safety-net for a country's insureds and insurers. A review of reinsurance programmes will strongly consider the regulatory requirements in the home country of the reinsurer.

The IAIS Core Principles, Essential and Additional Criteria are shown in the following box.

C.4.3 Reinsurance (IAIS Core Principle 10)

Insurance companies use reinsurance as a means of risk containment. The insurance supervisor must be able to review reinsurance arrangements, to assess the degree of reliance placed on these arrangements and to determine the appropriateness of such reliance. Insurance companies would be expected to assess the financial positions of their reinsurers in determining an appropriate level of exposure to them.

The insurance supervisor should set requirements with respect to reinsurance contracts or reinsurance companies addressing:

- the amount of the credit taken for reinsurance ceded. The amount of credit taken should reflect an assessment of the ultimate collectability of the reinsurance recoverables and may take into account the supervisory control over the reinsurer; and
- the amount of reliance placed on the insurance supervisor of the reinsurance business of a company which is incorporated in another jurisdiction.

Essential Criteria

1. The insurance supervisor has the authority to review the reinsurance arrangements to ensure that they are adequate and that the claims held by insurers on their reinsurers are recoverable. This includes ensuring that:
 - the reinsurance programme is appropriate to the level of capital of the insurer and the profile of the risks it underwrites; and
 - the reinsurers' protection is secure, which may be ensured by such measures as obtaining collateral (including trust, letters of credit or funds withheld) or by relying on a system of direct supervision of reinsurers.

Additional Criteria

1. A reinsurer which acts also as a primary insurer is subject to insurance supervision.
2. With regard to a reinsurer that does not act as a primary insurer (professional reinsurer):
 - The reinsurance supervisor has:
 - the necessary tools available for collecting, reviewing and analysing prudential reports and other information from reinsurers;
 - regular contact with the management of the reinsurer and a thorough understanding of its operations; and
 - the ability to monitor the activities of reinsurers and to intervene when necessary, including issuing cease and desist orders and instituting the winding up of the reinsurer.
 - The reinsurance supervisor is entitled to require reinsurance companies:
 - to define clearly the permissible activities they want to engage in;
 - to comply with requirements regarding ownership structure, management, operating plan, internal controls and financial position;
 - to have systems that accurately measure, monitor and adequately control market risks as well as to have a comprehensive risk management process; and
 - to have adequate policies, practices and procedures that safeguard high ethical and professional standards.
 - The reinsurance supervisor has the authority to cooperate, where appropriate, with other (re)insurance or financial supervisors to assess the financial position of a reinsurer that is:
 - part of an insurance or financial group;
 - participating in other (re)insurers or financial institutions, or in joint ventures or reinsurance pools; or
 - conducting business in or providing services to other jurisdictions.
 - The reinsurance supervisor, in assessing the reinsurer's financial position, takes into consideration:
 - the adequacy of technical provisions (policy liabilities) from both the ceding insurer's and the assuming reinsurer's perspective;
 - the adequacy of capital (solvency margin) to support the reinsurer's business operations;
 - the reinsurance program of the reinsurer itself; and
 - any effects of risk accumulation which result from the aggregation of reinsured insurance branches that are separate at the level of primary insurance.
3. The insurance supervisor:
 - has at his disposal the professional skills and tools to ensure independent validation of the received information; and
 - has the ability to share confidential information with other insurance supervisors. Information that flows between home and host supervisor may be based on agreed model forms for supervisory information.

C.5 INSPECTIONS / EXAMINATIONS (OFF-SITE AND ON-SITE)

Inspections (sometimes called examinations), are a key part of insurance supervision and are needed to determine the true financial condition of insurers, to assess the risks that they are facing and to analyse trends indicating future prospects. Insurance supervisors perform inspections in two ways:-

- Off-site - in the office of the insurance supervisor analyzing data provided by the insurer. Such information may be an annual return and contain audited annual financial statements, management accounts, insurance and reinsurance programmes, actuarial certificates, product ratings and literature, general or legal representative's certificate;
- On-site - in the office of an insurer to assess the risks of the insurer, corporate governance and internal controls. In the USA, and in some other jurisdictions, this is termed financial examination and there are specialist professional qualifications available such as certified financial examiner.

During both types of examinations, some insurance supervisors rely on third party professionals, such as independent auditors, to perform examinations on a regular or on an ad hoc basis.

On-site examinations can be regular occurrences or unscheduled, or a combination of each.

C.5.1 Off-site inspection - annual report

The annual report, or statement, is the formal, audited submission of every insurer. It includes all relevant financial and related data necessary for a review of the company's financial and operational status. In addition to typical balance sheet information the report should include volume and types of products sold, the detailed management expenses, the amount and type of reinsurance, etc. Although this formal submission is generally made on an annual basis, insurers are often required to submit quarterly reports but these might, or might not, need to be audited. Companies regarded as having potential problems should be asked to submit more frequent reports. The frequency required will depend on the resources of the supervisory authority and the condition of the company.

Insurance (statutory) accounting is different from Generally Accepted Accounting Procedures (GAAP). Thus, a public company, with reporting requirements to both a corporate or shareholder regulatory body and to an insurance regulatory body, usually finds it necessary to compile two different statements, each using different accounting procedures. The basic differences between statutory accounting and commercial (GAAP) accounting includes the basis on which assets are valued, terminology, insurance law restrictions, etc.

The annual report or statement is usually submitted several months after the close of the fiscal year. This delay can often run from two months to six months. Obviously, the closer the filing is to the end of the fiscal year, the more current is the information it contains. However, accounting for incoming reinsurance treaties and accurate long-tail reserving usually takes some time to assess accurately. Some regulatory bodies ask for unaudited management accounts at an early date to be followed by the full annual report within a longer specified time frame.

Financial tests

Solvency margins and requirements (European Union)

These requirements were introduced by a 1973 European Community Directive for non-life companies. They stipulate that solvency margins for a non-life company must be equal to the larger of:

Premium Basis: 18 per cent of gross premiums up to 10 million ECUs and 16 per cent of the balance of gross premium income, OR

Claim Basis: 26 per cent of average gross claims of three previous years up to 7 million ECUs and 23 per cent of the balance of average gross claims of the three previous years.

Note: Either basis is net of reinsurance up to a maximum of 50 per cent of premium cession.

For life companies, the solvency margin, established by a European Community Directive of 1979, is equal to the sum of the following calculations:

Four per cent of the mathematical reserves with a maximum of 15 per cent deducted for reinsurance cession, AND

0.3 per cent of the current excess of the insured sums over the mathematical reserves (capital at risk) with a maximum deduction of 50 per cent for reinsurance cessions.

(The deduction for reinsurance can only be taken once in either calculation.)

In many countries solvency margins are seen as a means of ensuring that the total assets of a company exceed the total liabilities by a pre-determined amount, usually a percentage. This can prevent unbridled growth (with resultant high costs and increased liabilities) without a concomitant injection of additional capital.

The IAIS Core Principles, Essential and Additional Criteria are shown in the following box.

C.5.2 Financial reporting (IAIS Core Principle 12)

It is important that insurance supervisors get the information they need to properly form an opinion on the financial strength of the operations of each insurance company in their jurisdiction. The information needed to carry out this review and analysis is obtained from the financial and statistical reports that are filed on a regular basis, supported by information obtained through special information requests, on-site inspections and communication with actuaries and external auditors.

A process should be established for:

- **setting the scope and frequency of reports requested and received from all companies licensed in the jurisdiction, including financial reports, statistical reports, actuarial reports and other information;**
- **setting the accounting requirements for the preparation of financial reports in the jurisdiction;**
- **ensuring that external audits of insurance companies operating in the jurisdiction are acceptable; and**
- **setting the standards for the establishment of technical provisions or policy and other liabilities to be included in the financial reports in the jurisdiction.**

In so doing a distinction may be made:

- **between the standards that apply to reports and calculations prepared for disclosure to policyholders and investors, and those prepared for the insurance supervisor; and**

Continued . . .

Core Principle Continued . . .

- between the financial reports and calculations prepared for companies incorporated in the jurisdiction, and branch operations of companies incorporated in another jurisdiction.

Essential Criteria

1. The insurance supervisor has the legal authority to require companies to submit information on both a solo and a consolidated basis, on their financial condition and performance.
2. The insurance supervisor has the authority to set the scope and frequency of reports requested and received from all companies licensed in the jurisdiction, including financial reports, statistical reports and actuarial reports.
3. The insurance supervisor has the authority to stipulate the principles and norms regarding accounting and consolidation techniques to be used for the purposes of reports provided to it for supervisory purposes.
4. The insurance supervisor requires insurance companies to utilize valuation rules that are consistent, realistic and prudent.
5. The insurance supervisor has the authority to issue principles for the establishment of technical provisions (policy liabilities) and other liabilities to be included in the financial reports in the jurisdiction.
6. The information has to be submitted on a timely and accurate basis. The insurance supervisor ascertains that the appropriate level of senior management is responsible for the accuracy of these returns, and can require that inaccurate information be amended.
7. The information includes details about off-balance sheet activities.
8. The insurance supervisor has a framework for on-going monitoring of the condition and performance of the companies. This requires that the insurance supervisor has an adequate information system.
9. The insurance supervisor requires that information is verified periodically through on-site examinations conducted by himself, external auditors or other qualified parties.
10. The insurance supervisor requires companies to produce annual audited financial statements.
11. The insurance supervisor has the authority to require insurers to hire, using their own resources, independent auditors or actuaries for auditing or reviewing all or specific items of the financial statements whenever the insurance supervisor has doubts as to their accuracy.

C.5.3 On-site inspections

There is great variation in the scope and frequency of on-site visits and in the reliability of outside persons (eg auditors, actuaries) who assist with, or carry out full inspections.

Regularly scheduled

Some supervisory authorities have set schedules for financial or other inspections of their insurers. These inspections vary in scope and depth and financial

examinations frequently become examinations of entire corporate operations. The scope can be limited or designed to fit the needs of a particular jurisdiction. The frequency of on-site inspections also varies, ranging from once every year to once every five or six years. Once again, frequency is related to the resources of a supervisory authority and the number and size of insurers under its jurisdiction. For the findings to be useful, on-site inspections must be completed and the final findings released, within a reasonable period.

Generally, on-site inspections are undertaken at the home offices or principal places of business of insurers but, sometimes, visits to branches and other offices are desirable. Inspections usually cover all records and activities of a company, not just financials. This could include a review of marketing practices, management practices, distribution methods, personnel and human resources, property maintenance, etc. Often one or more supervisory department examiners will be stationed at the insurer and, working with its employees, will gather appropriate material and information. It may be prudent if the same examiner did not conduct successive on-site inspections at any given company. During the course of on-site inspections, some of the information will be considered proprietary and will not be available for public release. This protection assists supervisors to gain the co-operation of insurers. It decreases a company's resistance to providing access to all product and other proprietary material and generates a more positive relationship between regulators and the regulated.

During on-site inspections, all financial data can be reviewed. An examiner will usually seek information which is unavailable in annual reports or support data for the information which is included. A supervisor might review underwriting criteria, claims procedures and the function of an internal audit department, if it exists. On-site inspections are only limited by the level of supervisory resources available.

An inspection process is intended to permit examiners to verify the accuracy and completeness of annual statements as well as allowing for evaluation of the data. An examiner will usually do the following:

1. Review the most recent previous statements, reports and accounting work papers.
2. Survey the types of available records and how they were prepared.
3. Obtain any additional data or supporting papers.
4. Cross-reference data to make sure an annual report accurately reflects the supporting data.

This check can include examinations of all the general expenses of an insurer. When a smaller insurer is examined, it is common in some jurisdictions, including the USA, to review all vouchers supporting disbursements. This might not be practical for larger insurers where taking samples will have to suffice. Other expenses reviewed are salaries, legal expenses, employee benefits, advertising expenses, management fees, distribution costs etc. This is only one example of the possible scope of an in-depth review. The same care should be taken in reviewing all areas of insurance operations.

Investment assets should also be reviewed carefully. For example, stocks and bonds held by an insurer should be inspected so as to:

1. Detect errors in securities records;
2. Determine securities that are recorded but not held by the company;
3. Discover any improper valuation;

4. Determine any violation of insurance or other laws, conflicts of interest or improprieties on the part of insurance company personnel.

An examiner is interested in knowing not only what investments are held but also the accuracy of the reporting and evaluation of those investments.

When examinations are completed, and the aim should be to do this as expeditiously as possible, a report is generally drafted and reviewed with the insurer. Any problems or potential problems are discussed and arrangements are made for insurers to find remedies. Usually there is a statutory or administrative mechanism which will enable an insurer to protest any finding which it believes to be unfair or inappropriate.

This method of examination provides a complete review of the financial, operating and management conditions at a given company. It also presents opportunities for regulators to obtain a 'hands on' view of the internal culture and environment. The 'tests' which follow are used as warning signs to alert regulators to undertake more extensive examinations. Such examinations are the only way to obtain an in-depth understanding of a company's financial stability.

Examination as needed

No matter how useful complete on-site examinations are, it is often impossible to conduct them as broadly or as frequently as chief supervisors might wish. Some jurisdictions, hampered by low budgets and staff shortages, might consider such exhaustive examinations only when companies reveal a problem through other required information. For example, assuming that all insurers must file annual reports or statements with a supervisory authority, the information supplied might raise questions about the financial or overall stability of the insurer. This would 'flag' an alert to supervisors for the need for a more exhaustive examination. As has been discussed, some countries have established tests or checklists designed to draw attention to companies in real or potential trouble.

Examinations can also be triggered by consumer complaints or by an adverse rating from an independent rating company, or by media attention. In short, any adverse publicity which might affect or reflect on the stability of a company could trigger in-depth examinations. Unfortunately most information submitted to regulators is historic so it is important that they keep up-to-date with information by maintaining regular contact with their insurance market.

Combinations

A 'middle-of-the-road' position for countries with limited resources might be to schedule regular on-site examinations and/or with less scope than the ideal model. Adverse indications gathered from annual statements or other sources, could trigger more extensive examinations in the interim. If a potential problem seems isolated, an examination might focus only on that area of concern. Thus, examinations for cause could complement regular scheduled examinations and reduce the risk of a troublesome situation going undetected until it has escalated beyond repair. This type of examination framework permits regulators to maximize their resources-particularly in countries with small insurance industries and markets.

Some insurance regulators rely on external auditors to perform examinations as part of their annual audit of clients. Such regulators should request copies of the confidential auditors' report to the insurer outlining weaknesses in systems, personnel and other deficiencies.

The IAIS Core Principles, Essential and Additional Criteria are shown in the following box.

C.5.4 On-site inspection (IAIS Core Principle 13)

The insurance supervisor should be able to:

- carry out on-site inspections to review the business and affairs of the company, including the inspection of books, records, accounts, and other documents. This may be limited to the operation of the company in the jurisdiction or, subject to the agreement of the respective supervisors, include other jurisdictions in which the company operates; and
- request and receive any information from companies licensed in its jurisdiction, whether this information be specific to a company or be requested of all companies.

Note: The Supervisory Standard on On-site Inspections should be reviewed in order to obtain a comprehensive overview of on-site inspections.

Essential Criteria

1. On-site inspection must have a legal basis giving the insurance supervisor wide-ranging powers to investigate insurance or reinsurance companies and to gather information he or she deems necessary.
2. Where insurance supervisors undertake a full-scale on-site inspection, this includes at least the activities listed below:
 - evaluation of the management and internal control system;
 - analysis of the company's activities;
 - evaluation of the technical conduct of insurance business, eg evaluation of the organization and the management of the company, analysis of the commercial policy of the company and evaluation of the reinsurance cover and its security;
 - analysis of the relationship with external entities; and
 - evaluation of the company's financial strength.
3. The insurance supervisor has the authority to conduct on-site inspections on a limited basis, investigating only areas of specific concern.
4. The insurance supervisor should discuss findings with, and obtain feedback from, the insurance company.
5. Insurance supervisors should follow up to ensure that any required action has been taken.

Additional Criteria

1. The insurance supervisor has the authority to extend on-site inspections to brokers and companies that have capital links with, or that have accepted functions outsourced by, the supervised company.
2. Where insurance supervisors have the necessary powers to deal with the treatment of the customers, they may include the following points in the on-site inspection:

Continued . . .

Core Principle Continued

- review of the information given to customers and checking of its sufficiency and adequacy;
- review of the time for payment, the number and nature of litigation and the transactions with the policyholders; and
- assessment of observance of the consumer regulations.

C.5.5 Actuaries and auditors

Actuaries play important roles in providing annual statements, financial reports and projections required by supervisory authorities. They are also essential to the operations of life insurance companies by developing appropriate models for probability and degree of risk. The position an actuary holds, however, differs between jurisdictions. Generally, an actuary is responsible for ensuring that an insurer's technical reserves when considered together with income from future premiums, is sufficient to enable a company to pay its obligations arising from policies when they are due. The expectations in respect to the work of actuaries and their important professional responsibilities apply equally to non-life as well as life insurers. Non-life actuaries are increasingly being used, especially where there are long-tail liabilities covering losses that have occurred but which take some time to quantify and resolve, eg asbestosis claims. The following discussion applies mainly to life companies since it is common for non-life companies to employ the services of an outside actuary or actuarial firm either, regularly or on an 'as needed' basis.

Most jurisdictions insist on auditors being independent of the insurers they audit and approved by the supervisory authority either as to qualifications in general or as to specific nomination. Auditors must not only determine the accuracy and completeness of information in annual reports, they must also assure compliance with appropriate statutes and regulations.

Usually an actuary or auditor will be members of a professional institute. The training of members is rigorous. They will also have strict professional, technical and ethical standards. External auditors are required to report in financial statements prepared under 'generally accepted accounting principles' agreed by professional institutes. Larger firms of auditors employ professionally qualified accountants who specialize in insurance. They might also employ their own actuaries to carry out independent assessments of technical reserves. The fact that an audit is performed by independent practitioners who are highly competent and strictly controlled allows them to be sued if they are negligent. This gives insurance supervisors a certain amount of comfort. It is significant that if an auditor is negligent, policyholders can be compensated through court action. In many countries statutes require auditors and chief actuaries must report to insurance supervisors if, during the course of audits or examinations, they discover transactions or practices which give cause for concern. In many countries, independent firms of auditors are used by insurance supervisors to perform independent investigations when necessary. When using independent firms of auditors and authorizing them to be auditors of insurance companies, it is important to ensure they are members of a recognized professional body known to take strong action if there are any breaches of ethics or work standards. In addition, it is vital that auditors specialize in audits of insurance companies whose audit is always technically complicated. Professional institutes usually make their codes of conduct and ethical requirements of members available to insurance supervisory authorities.

Statutory mandate

Some jurisdictions insist that a life insurance company's management includes a chief actuary who oversees all financial predictions of the company. His role is to certify the accuracy of the level of reserves in the light of policy obligations as well as to monitor any occurrences which would necessitate any changes. A chief actuary is also responsible for providing the information crucial to a number of the 'tests' referred to previously.

In addition to requiring that a chief actuary should satisfy certain levels of training and experience, some jurisdictions require them to have dual roles. Not only to assist an insurer to arrive at actuarially sound reserve levels and risk practices, but also to report any failures to the regulatory authority. In other words, he must serve as a representative of the supervisory authority as well as an employee of the insurer. Because insurers meet the costs of actuaries, there is no question of conflicts of interest. Despite this, it seems to work well in jurisdictions where a solid level of trust has been established between a regulator and the regulated. It is questionable whether such dual loyalty works in developing markets where consumer confidence is fragile.

Smaller companies may hire outside actuarial firms to fill the post of chief actuary so that they need only pay for time spent, rather than the cost of a full time salary and benefits. Nevertheless, in countries with virtually no trained actuaries, it may be difficult to obtain a chief actuary with appropriate training and experience.

Internal actuary

Some jurisdictions believe that the appointment of an actuary is an internal, managerial decision and should be left to the discretion of company management. There might still be a requirement that certain reports and reserve calculations and monitoring are performed by a licensed actuary, but any other activities would not necessarily concern a regulator. There may also be no statutory or regulatory requirement imposing a duty of an actuary to report any problem or impropriety to a supervisor. However, it is common for an actuary's professional society to embody such a requirement in its own code of ethics.

This method may work well in a system in which an actuary already has an accepted role. It would not resolve the problem of an insufficient number of actuaries because trained and experienced individuals would still be needed to carry out certain responsibilities. It would seem, therefore, that one of the major issues facing a supervisor is to assure that adequate actuarial training is available and that candidates are available for such training. Until a training course can be established domestically, it might be feasible to send students abroad for training or, to import trained actuaries on short-term contracts.

That actuaries have a key role in the adequate function and regulation of the life insurance business is inescapable. Ensuring the development and training of actuaries is an essential task facing all supervisory authorities.

C.6 MONEY LAUNDERING AND FRAUD

Money laundering refers to any technique, procedure or process by which funds obtained illegally, or obtained through legal sources, but held or used in criminal violation of other laws, are ultimately converted into other assets or forms so as to conceal the source of the funds or the manner of their receipt. Although money laundering is frequently thought of in terms of proceeds from trafficking in drugs, numerous other illegal acts, may also involve laundering funds.

Generally, where the activity involves more than one jurisdiction, the illegal act from which the funds are generated must be recognized as a crime in both originating and receiving jurisdictions. Sometimes tax evasion can be the crime committed in one jurisdiction before the proceeds are transmitted to another jurisdiction.

In the insurance business, the proceeds received for the payment of premiums may involve cash, or may involve cash equivalents, such as cheques, travellers' cheques or bank drafts. An insurer can be involved in money laundering if any premiums are paid with the proceeds of crime.

If an insurer receives cash, there can be a question about the source of the cash and a possibility that the insurer, a legitimate business, is being used to launder the cash. When cash is received for premium payments, the possibility exists that it is the first step in a laundering process in the conversion of the cash into a policy.

Regulation of an insurer for involvement in money laundering assumes that a jurisdiction treats money laundering as a crime or an unacceptable act. Jurisdictions that discover money laundering usually impose severe penalties on insurers for failing to comply with specific reporting requirements and for knowingly receiving laundered funds, and/or for participating in a transaction that serves as a conduit for laundered funds.

Regulation frequently seeks to define 'knowingly'-namely what kinds of conduct on the part of company officials or insurance sales personnel constitutes knowledge of illegal acts.

The Financial Action Task Force on Money Laundering has carefully reviewed the interaction between financial services' regulation and the prevention of money laundering. It has specifically made forty recommendations which it believes will greatly facilitate the prevention of money laundering by using financial services transactions. Seven of these are specifically related to the regulation of insurance and reinsurance.

C.6.1 Informal system on a case-by-case basis

Some jurisdictions might look for isolated questionable transactions as part of the overall examination procedure or when given reason to believe an improper transaction has occurred. This provides a regulator with broad latitude and discretion to investigate the affairs of an insurer. For the approach to serve as a meaningful deterrent to would-be insurance money launderers the penalties for violations need to be made clear. The penalties must be high enough to make money laundering unprofitable but low enough to prevent insurer insolvency.

Preventing insurer fraud and money laundering activity on the part of employees is greatly assisted by the establishment of an internal audit department headed by a qualified auditor. This executive should be charged with responsibility for conducting investigations within an insurer to identify wrongdoing and to identify areas in the business in which there is a higher likelihood of questionable employee conduct. Areas which involve higher risks of wrongdoing require special policies and procedures. Insurer personnel might need to be dedicated to oversee the implementation and adherence to anti-money laundering policies and procedures. When violations are identified, it is an insurer's responsibility to redress and correct these irregularities. Once brought to the attention of a regulatory authority, a regulator must decide whether to impose penalties on the insurer in addition to taking action against the wrongdoers. A regulator will be

influenced by whether or not an insurer took adequate steps to prevent such fraud or money laundering.

This informal approach creates no clear standards as to what is, or is not, acceptable conduct and grants extremely broad discretion to a regulator. The elimination of predetermined standards creates a situation which makes money laundering and fraud more difficult to detect and regulate.

C.6.2 Statutory standards

Statutory standards can be put into place either by insurance legislation or by giving statutory duties to supervisors for regulating insurance in the same way as other financial services and commerce is regulated. If the legal system is already highly developed in this area, with stringent overall regulations in place, then specific insurance regulations are not needed. Nevertheless, it would be appropriate to establish the principle under insurance regulation that the violation of criminal laws by an insurer or insurer personnel could also constitute grounds for revocation of an insurance licence or attract other penalties that an insurance supervisory authority deemed appropriate under the law.

If, however, the general statutes do not appear relevant to the insurance industry, then specific statutes could be incorporated into the insurance law. The regulations could not only prohibit certain activities or deem them illegal, they could mandate some preventative measures, too. For example, they could require the appointment of a chief auditor, could mandate that employees working in areas of the insurer most likely to succumb to fraud be required to take a vacation of two consecutive weeks in order to have someone else monitor their transactions, and they could warn of circumstances that would trigger the need for further examination to stop fraud becoming deeply embedded in the upper management of a company. The cultural and economic climate of a jurisdiction will influence the degree to which these activities are pursued. For example, jurisdictions with legal systems providing a high degree of privacy to their financial service customers might find it more difficult to investigate money laundering.

C.7 INSOLVENCY, REHABILITATION AND LIQUIDATION

The major issues to be faced here are the circumstances under which an insurance company can be permitted to fail. Most jurisdictions would respond that it is the role of a supervisory authority to maintain sufficient control so as to prevent failure. Others might conclude that although the owners, or management of a company might be permitted to fail and suffer financial loss, the policyholders should not suffer. Others consider that sophisticated commercial policyholders are different from individual purchasers. When reviewing different options, it is prudent to remember that a strong, well-established insurance industry can withstand financial problems to a much greater degree than a new market which is still trying to convince the consuming public to participate. An early erosion of consumer confidence can take decades to repair. This is why this manual omits the 'no- protection' option. It will focus instead on prevention and, if this fails, on protective measures.

C.7.1 Legal responsibility

Controlled by supervisory authority

Because insurance is an internationally regulated industry involving the monitoring of the financial well-being of insurers, many regulators are encouraged to deal with an insurer during or after financial crisis and/or insolvency. By work-

ing with a court, regulators have a significant role in establishing liquidation priorities and in ensuring that assets are preserved for the benefit of policyholders.

Usually, when a regulator takes control of an insurer's insolvency and subsequent liquidation, the relevant statutes or accompanying regulations have an established list indicating the order of priority for recipients of recovered assets. Tax liabilities, policyholders' claims, liquidators' fees and bank interest will usually come first. Creditors come next, with shareholders last. It is unusual for payments to extend beyond policyholders. If a guarantee fund exists, this can be used to pay policyholders. This will be discussed in later section on guarantee funds. It should be noted now, however, that guarantee funds are seldom used to pay claimants other than policyholders.

A court is the body which officially oversees the actions of a supervisory authority when dismantling a company. In cases where a supervisor chooses to rehabilitate, rather than to liquidate, a court can act as overseer. In countries with complex legal systems, a court with jurisdiction over insurance liquidations or rehabilitations, would not normally be the kind of court which deals with ordinary commercial or individual bankruptcies.

Treaties with general bankruptcy procedures

Normal bankruptcy procedures can be used to undertake the rehabilitation or liquidation of an insurer. However, it should be recognized that such procedures need to be initiated by supervisors. The special situation of policyholders in a bankruptcy or rehabilitation process, require normal bankruptcy procedures to be tailored to meet their needs. A general reorganization normally requires the cessation of business obligations during the process. After a bankruptcy is declared, the obligation to customers is, at best, put on hold. This cannot be the case with an insurer because policyholder claims are ongoing. The majority of assets controlled by insurers are policyholders' and claimants' funds. Insurers are required to administer these funds as if they are trustees. Therefore, placing insurance company failures within the regular bankruptcy system creates a need for a complex and difficult statute. It might also create enforcement problems if a supervisor is excluded.

C.7.2 Guarantee funds

Pre-assessment

Statutes which establish a pre-funded guarantee system generally require that a percentage of an insurer's premiums are set aside to assist claim payments to policyholders should an insurer become insolvent. Members of both pre-funded and post-assessment guarantee funds are all insurers licensed in a particular state, country or other jurisdiction. Life and health companies along with general insurance companies, usually contribute to separate funds. These funds can be administered by the insurance department or by an independent body, composed of members of the insurance industry. The funds can be used for rehabilitation as well as liquidation-usually at the discretion of the fund's administrator or as specified in statutes.

The way in which such funds are invested, and the percentage of contributions is determined by statute. Special attention is given to companies whose contributions would place them in financial jeopardy. Sometimes a minimum contribution is required but, more frequently, there is a maximum cap on the total of contributions made annually. The advantage of a pre-assessment fund is that the funds are already in place and a troubled insurer has made at least some

contribution to the rescue of its policyholders. Interest is earned on the fund and enables it to grow. This can negate further draw-downs, unless there is an insolvency.

The disadvantages of pre-assessment are that insurers are asked to contribute to the funds which may never be used and which are solicited with no regard to the possible cost of an insolvency. Because such funds require contributions, whether or not there is an insolvency, there is less incentive for industry members to monitor their colleagues.

Post-assessment funds

Post-assessment funds, are generally managed by independent boards of industry members, with the oversight of an insurance department and do not receive funds until an insurer is placed in liquidation or, in some cases, into rehabilitation. At that point, the cost of meeting statutory obligations to policyholders is determined and a call is made on all members based on the percentage of premiums earned within a jurisdiction and a specified time frame.

Usually a cap is placed on the percentage of an insurer's assets which can be called in a given year (generally 2%-3%) and no insurer need pay on a call if such payment would place it in financial jeopardy. Calls are due and payable immediately on issuance of a liquidation order. However, if the liquidated assets are sufficient to pay all or some policyholder claims, then the proportion of a call not used for such payment will be returned, pro rata, to each contributory insurer. Many jurisdictions permit insurers to make calls tax deductible but, any refunds are taxable.

The advantage of post-assessment funds is that they give greater control over the value of a call. Insurers need pay only what is required to 'do the job'. Because solvent companies do not create calls, there is a strong incentive for companies to monitor their colleagues, and press insurance regulators to act quickly in the case of a potential insolvency. Because any 'over-assessment' will be returned, there is also an incentive to handle rehabilitation or liquidation as quickly and efficiently as possible.

A disadvantage is that an insolvent insurer may have made no contribution towards bailing out its policyholders. Also, in the case of a large assessment for the failure of a major company, there is always the fear that the statutory cap will prevent full coverage. This might be more of a risk in a market where all or most insurers are relatively new with little surplus cash and reserves to release as a lump sum when assessed. On the other hand, a pre-assessment based on percentages of premiums received may represent a manageable amount contributed on a regular basis.

Those responsible for managing a guarantee fund in both post and pre-assessment scenarios should try to sell the book of business of the insolvent insurer. This is particularly important for life funds since many statutes require not only that claims be paid in the short term but that the policies themselves be continued. This is an attempt to compensate for the fact that life and health insurance obtained at a given age and health status is irreplaceable. An individual purchasing a life policy at 20, in good health, cannot replicate that coverage at 50, especially after suffering a heart attack.

Guarantee funds also can assist the rehabilitation of insurers by providing funds to resolve a short-term crisis. Legislation could view this as a loan, which the assisted company would pay back when, and if, it is rehabilitated. The loan can be interest free or low-interest. The circumstances under which such a loan

would be made must be reviewed on a case-by-case basis, which means it is best to include the guidelines in regulations rather than statutes. When guidelines have been in place for some time, they might be incorporated into statutes.

Generally, guarantee funds cap the potential liability of an insured. Their purpose is to provide reasonable coverage to policyholders and not obligations in full. Thus, an individual with a \$1,000,000 life insurance policy might receive only \$300,000. Some jurisdictions also treat sophisticated investors differently from less sophisticated investors. These factors vary and depend on the nature of an insurance market and the confidence of consumers. After all, a guarantee fund is primarily a device which reassures consumers that they will be protected if their insurer fails.

SUMMARY

Module C describes some of the main tools available to supervisors for monitoring the financial stability of insurers in their own jurisdictions. It also reviewed a supervisor's role in monitoring company solvency and financial status. In addition, it focused on investment strategies and the statutory and regulatory oversight functions for those strategies. The monitoring and prevention of money laundering was included because it is an urgent and growing problem. It also considered regulatory rehabilitation and liquidation both as independent functions and as part of a general code of bankruptcy.

The use and establishment of guarantee funds, established from the resources of different insurers, were reviewed. Discussion focused on the structure and rationale for guarantee funds for both the life and non-life industries. The purpose of these instruments and the ways in which they can be used, were reviewed.

Emphasis was placed on the role of on-site inspections (financial examinations). There was discussion of their various uses and the best way they can be structured. The roles of actuaries and auditors were reviewed from several perspectives.

MODULE D

MARKET CONDUCT

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D.1 MARKET CONDUCT

There is no single method for jurisdictions to supervise insurance intermediaries who distribute insurance in many different ways. Each method has given rise to different regulations and legislation. Insurance is usually sold directly (by mail, internet or company employees) or retailed by agents or brokers. An agent represents the seller*; he may represent only one insurer (a tied agent) or be multi-tied (ie act for many). In some jurisdictions, tied agents are permitted to sell products other than those of the insurer/s for whom he acts, when the other products are more suitable for particular clients. This limited exception protects consumers by removing reasons for agents to sell unsuitable products. The sales contracts, however, are usually processed through the prime insurer.

A broker represents the buyer and will generally work with several companies to provide the best coverage for his clients. In some countries, such as the USA, it is common for brokers to sell general and commercial insurance and for agents to sell life, health and similar products but this system may vary in other parts of the world. Because of different issues affecting agents and brokers, they are handled separately. Brokers are independent of company affiliations and there are usually less opportunities for companies to control or monitor their activities. An insurer may well perform a due diligence examination when dealing with insurance brokers.

The IAIS Core Principles, Essential and Additional Criteria are shown in the following box.

D.1.1 Market conduct (IAIS Core Principle 11)

Insurance supervisors should ensure that insurers and intermediaries exercise the necessary knowledge, skills and integrity in dealings with their customers.

Insurers and intermediaries should:

- **at all times act honestly and in a straightforward manner;**
- **act with due skill, care and diligence in conducting their business activities;**
- **conduct their business and organize their affairs with prudence;**
- **pay due regard to the information needs of their customers and treat them fairly;**
- **seek from their customers information which might reasonably be expected before giving advice or concluding a contract;**
- **avoid conflicts of interest;**
- **deal with their regulators in an open and cooperative way;**
- **support a system of complaints handling where applicable; and**
- **organize and control their affairs effectively.**

Note: Principles for the Conduct of Insurance Business should be referred to in order to obtain a full view of market conduct principles. Supervision of the activities of insurance intermediaries may be undertaken by a separate body or bodies to that responsible for the supervision of insurance companies.

Continued . . .

* The law of agency in different jurisdictions is complex and not always too clear.

Core Principle continued

Essential Criteria

1. The insurance supervisor requires that insurance entities (insurers and intermediaries) have key functionaries who are and remain fit and proper for their roles (ie possessing the necessary knowledge, skills and integrity for their positions), and has effective means to enforce this.
2. The insurance supervisor requires insurance entities to have policies in place on how to treat customers fairly.
3. The insurance supervisor has the capability to carry out on-site inspections to check observance of the required standards of market conduct where necessary.
4. The insurance supervisor sets policy and guidelines with regard to disclosure to the customer or relevant, meaningful and understandable information in a timely manner. The information to be disclosed covers the insurer, intermediary, product, risks, benefits, obligations, charges and estimated returns as appropriate.
5. The insurance supervisor requires insurance entities to seek information from their customers that might reasonably be expected, before giving advice or concluding a contract.
6. The insurance supervisor requires insurance entities to have in place procedures to deal with conflicts of interest. These might include disclosure, internal rules of confidentiality, or other appropriate procedures.
7. The insurance supervisor requires insurance entities to deal with complaints of customers effectively and fairly through a simple and equitable process. The process is well disclosed and easily accessible.
8. The insurance supervisor has procedures available to it to stop persons or entities doing unauthorized business quickly and effectively.

Additional Criteria

1. Intermediaries are directly or indirectly supervised. Regulation may cover issues like registration, knowledge and skills, codes of conduct, complaints procedures, professional indemnity insurance, continued professional education, etc.
2. If the insurance supervisor does not have authority to resolve disputes, it encourages the setting up of an alternative dispute resolution mechanism to deal with complaints in an effective and affordable manner. It is advisable that this should be a neutral body that reports publicly on at least an annual basis.

D.2 AGENTS

Mandatory licences

Some jurisdictions restrict insurers and insurance intermediaries to advising or selling insurance products only through authorised agents or employees. To reduce the administrative burden on insurance supervisors these agents are authorised by the principal or the employer. In such cases, insurance supervisors have the authority to direct insurers or insurance intermediaries to stop any

authorizations when agents or intermediaries are deemed to be 'not fit and proper'.

Most jurisdictions not only require agents to be licensed, but also stipulate the conditions under which licensing is granted or renewed. Prescribed education or training is often a prerequisite for licensing and is achieved through the successful completion of an established programme or curriculum. Some jurisdictions insist that written examinations are passed before licences are issued.

In the case of tied, or exclusive, agents an insurance company is often included in the licensing process to assure regulators that an agent is genuinely working on an insurer's behalf. Multi-company agents may need written acknowledgment from every insurer whose products he sells. When agents represent only one insurer, their licence can be suspended or revoked if their insurer withdraws authorization.

It is common for licence renewal to depend on continuing educational requirements for all agents. A licence issued by a supervisory authority can be suspended or revoked for any violation of insurance laws and regulations. Sometimes suspension or revocation can occur at the discretion of a regulator. Such suspension, however, is usually accompanied by a hearing giving agents the chance to defend themselves. It is common for a licence application to be denied if applicants have engaged in any improper conduct or have been convicted felons. These standards vary from country to country some of which deny licence applications for even minor convictions.

Some jurisdictions require additional licences for agents selling more sophisticated investment-related products. These licences generally involve additional training and testing as well as greater scrutiny of an applicant's background. There are also countries that transfer the regulation of agents from a supervisory authority (except in extreme instances, such as fraud) to a self-regulating body of an agents' peers. In such circumstances and often with the oversight of a supervisory authority, and specific enabling regulations, agents conduct and licence requirements are controlled by their peers. This method is most effective when there are well-understood standards of appropriate conduct and strong unfair practice statutes and regulations.

Non-licensing or self regulation

In a few jurisdictions agents need not be licensed. Such jurisdictions may regulate insurance products so closely agent licensing is deemed unnecessary. There may also be strong marketing and distribution regulations which stop just short of licence-issuing requirements. In new markets, where consumer confidence and knowledge is low, and where agents might be inexperienced, it is wiser to regulate agents and products. Such regulation increases the chance of consumers receiving accurate and complete information and being sold products suited to their needs and circumstances. Licensing processes also provide supervisory authorities with a disciplinary tool (suspension or revocation of licences) when agents act improperly or irresponsibly.

D.2.1 Liability

Insurer liability

Because agents represent sellers, it is assumed they speak for sellers, or the insurer. It is now common that the acts of tied or exclusive agents are understood as being undertaken with the knowledge and consent of an insurer. In other words, an insurer has a specific responsibility to discipline and control its

agents. The role of a multi-company agent is less clear. Most jurisdictions still impose responsibilities on insurers for the actions of their agents. In both instances, it is possible for insurers to show that an agent has been trained or instructed to act properly and not improperly. Although this gives insurers the right to take action against their agents, it does not absolve insurers from their responsibilities to consumers. The difference between the liability of a company selling through tied agents and through multi-company agents is most apparent in relation to the degree of care needed to monitor and train the agents. The manner in which an insurance company allows an agent to represent it to a client should also have some effect on the way liability is shared between agents and insurers. There is always an area of undefined responsibility in cases where agents have not made clear to clients which insurer he is representing.

Agent liability

As noted above, it is unusual for agents to be solely responsible for their dealings with customers, unless they indicate they are acting independently and not in the interests or according to the instructions of the insurance company they are representing. But, the degree to which a jurisdiction's statutes hold insurers responsible is directly related to the principle of caveat emptor - 'Let the buyer beware'. Where there is powerful consumer protection, the more insurers will be held liable for the actions of their agents.

Generally, when viewing agent improprieties or unfair trade practices, a regulator will be interested in learning about the training and instruction given to agents by insurers. Actions such as improper use of clients' funds, failure to forward premiums and similar acts, may not create liability for insurers, unless collusion or conspiracy is proven. These are misdemeanors for which agents are responsible. However, misrepresentations of policy terms and claims payment practices, the falsifying of applications, failures to relay material information to clients and misrepresentations of fees by agents, make insurers directly liable.

Some jurisdictions insist that agents hold 'errors and omissions' insurance or professional liability insurance to protect policyholders from financial damage caused by agents. In the case of tied agents, premiums for such insurance can be paid for either by agents or insurers.

D.2.2 Insurer / agent relationship

Tied agents who are employees

Regulation of insurance agents is important not only in determining liability issues but in regulating commissions, benefits and tax issues. If agents are full-time employees, in many jurisdictions they become eligible to receive all the benefits, and obligations, common to all of the insurer's other employees. The assumption is that the agent is totally tied to a single insurer and can only represent that employer. The issue of an agent's personal liability becomes irrelevant since it is assumed the agent speaks directly for his employer.

Also, employees do not usually have the same freedom to structure their business activities or to be involved in overall financial planning. Usually banks, direct marketing companies and related financial services institutions will use full-time employees for the selling and marketing of insurance products. A difficult question facing regulators is whether such employees should be licensed as agents and what information they should disclose to clients about their relationship with their employer. Consideration should also be given as to whether employers should be compelled to provide professional indemnity or liability

insurance for their agent/employees. Points raised in the previous sections are also relevant here.

Non-employee agents

Agents can also be self-employed contractors with some benefits coming from a prime insurer. These benefits could include health insurance, investment opportunities, secretarial assistance, office space and, in some instances, a guaranteed minimum income for, at least, the first few years. The scope and variety of benefits will depend on the competitive nature of the marketplace and the volume of business generated by such agents.

An insurer might also provide training and marketing assistance. But, unlike an insurer's employees, an agent will arrange his own schedule, might operate under his own name, and would be paid as an outside contractor. This kind of arrangement reduces the apparent authority of the agent and could, arguably limit the level of agent liability.

D.3 BROKERS

D.3.1 Licensing

Strict licensing and controls

Because brokers represent clients, rather than insurers, their marketing practices are often subject to less supervision or control. Brokers are in a unique situation as the representative of a buyer but receiving payment from an insurer. Due to possible conflicts of interest, there could be strong arguments for strict licensing and control of brokers by supervisory authorities. A broker's licence could depend on a specified training curriculum relating to insurance and marketing principles in addition to specific knowledge of products or types of products. There could also be long-term educational requirements which must be met before licences are renewed. The curricula could be specific to life or non-life insurance depending on an applicant broker's field of activity.

The licensing process could involve written exams as well as proof of minimum training or course work. Applicants should have no criminal record or evidence of a prior breach of fiduciary duty. Some jurisdictions require industry experience either as a trainee or under a temporary licence which might become permanent after a while. Strong regulation of brokers, particularly in a rapidly expanding economy with increasingly complex insurance needs, can help protect clients and encourage confidence in the insurance industry. In economies with many sophisticated purchasers, licensing requirements might not be as strict.

In addition to licensing prerequisites, some jurisdictions place controls on the sales or sales practices of their brokers. A broker may be required to determine the suitability of a product for a particular client or, in some cases, to apply minimum suitability requirements. For example, it would probably be deemed unsuitable for a broker to sell a 95 year old a life annuity.

By licensing brokers, a supervisor increases control by being able to suspend or revoke licences for unfair or improper trade practices. As with agents, if brokers err in selling, a policy is not automatically revoked. Jurisdictions might also wish to consider insisting that brokers hold either 'errors and omissions' or professional liability insurance.

Minimal or no licensing

In jurisdictions with strict control over products and marketing, there may be less need for strict licensing requirements. There could be reliance on mandatory disclosure of commissions and related data to indicate financial relationships between brokers and insurers. However, where licensing is not required, the registration of brokers might be necessary so there is some accountability. Because brokers do not represent a specific insurer, no single entity is responsible for their actions. Consumers, however, might be attracted by the apparent independence of a broker suggesting impartiality in the choice of insurer. Efforts should be made to make buyers (particularly when relying on a broker for decision-making as well as information-gathering) aware of any financial relationship between brokers and the insurers whose products he promotes. Opting not to license brokers can create problems for regulators. These can have a serious, detrimental impact on a developing market. Such an option should only be selected after careful consideration of underlying reasons.

D.3.2 Foreign brokers

Domestic presence

Some jurisdictions, to maintain tight control over their brokers, will license only those with a domestic presence. The strength of this presence can vary from mandatory residency to the establishment of an office. In addition to gaining greater control over brokers, a supervisor's presence increases the likelihood that the locally resident broker is in business for the long-term.

In designating residential requirements, an emerging or developing market should consider the desirability of experienced brokers who are not residents or citizens. This may be accommodated by allowing foreign brokers to form joint ventures with residents. However, this is not always a realistic option and might conflict with the rules of trade globalization bodies such as WTO which many developing countries have joined.

Cross-border sales

Several recent international agreements encourage cross-border sales. Although such agreements do not permit residential requirements, they do not necessarily prohibit the licensing or registration of brokers.

The obligations of international free trade treaties go beyond those of insurance regulation. However, if such treaties are not relevant, then at least prudent regulation, if not stringent controls, should be placed on cross-border sales.

D.3.3 Sales to multinational companies

There are no clear-cut guidelines for the control of sales to multinational companies seeking to have their home country insurance follow them around the globe. In all probably, much will depend on the importance of providing a comfortable environment for international business and investment. Until a market becomes established, these issues could be decided on a case-by-case basis with guidelines written into regulations. There might be a requirement that domestic brokers participate in an accommodation with a licensed insurer who is licensed in its home country and, in most if not all, other countries where it conducts business. Insurance such as motor insurance/workman's compensation and public liability on risks within such a jurisdiction, might need to be covered by a licensed domestic insurer while insurance for temporary residents and employees could follow them from their home nations. Many combinations are

possible. This is also an issue which will face developing countries in respect of all their financial markets.

D.4 OTHER INSURANCE INTERMEDIARIES

Other types of insurance intermediaries are also supervised by some jurisdictions. One example is the business of a claims' loss adjuster or assessor. Such insurance consultants might give advice to prospective policyholders without involvement in the selling processes.

An insurance supervisor should consider whether every different category of insurance intermediary should be supervised.

D.5 CONSUMER COMPLAINTS

In addition to using annual statements and financial examinations to monitor the financial well-being of an insurer, a supervisory authority might find that complaints from consumers will help highlight certain inappropriate behavior. Usually insurance supervisors do not have powers to resolve disputes between insurers and policyholders. Such disputes are for the legal system and the courts. However, insurance supervisors will often ensure that a complaint which has merit, is dealt with at a senior level within the insurance company concerned.

D.5.1 Active supervisory involvement

Some jurisdictions have established complex and active Consumer Affairs (Ombudsman) Bureaux or special divisions within their supervisory authorities. These are geared to:

1. Receiving consumer complaints.
2. Categorizing each complaint as to type and insurer.
3. Responding in conjunction with the insurer.

In more complex markets, a Consumer Affairs (Ombudsman) Bureau may be divided between complaints against an insurer, and complaints against its sales and marketing practices. Complaints lodged directly against an insurer usually involve failure to cover a risk during the underwriting process, or a failure to pay a claim. Statistics indicating a company's failure to pay claims promptly and appropriately can be useful when monitoring the financial condition of an insurer because slow payments and increased claim denials frequently indicate early signs that an insurer is in trouble. The active participation of a supervisory authority in resolving a complaint will also often give valuable extra insight into the financial and operational status of an insurer.

Resources, culture and economics all play important roles in determining the necessity for establishing a large Consumer Affairs (Ombudsman) Bureau. In some cultures it is unusual for consumers to complain to the authorities. This negates the value of dependence on consumer complaints.

D.5.2 Insurer resolution

Another option is creating a division to receive complaints and to process requests for information. This can serve as a conduit for passing complaints and requests to relevant insurers while tracking the number and type of consumer contacts concerning a particular insurer. Notice should be taken of an increase in complaints concerning claim payments or other issues indicating an insurer's

well-being. An authority should follow-up complaints if only by sending a post card to a complainant to find out if there has been a satisfactory outcome.

Consumer requests for information can also be helpful to a supervisory authority. If questions are asked about the products or methods of methods of particular insurers this can be significant enough to prompt further regulatory inquiries. Depending on the information sought, a chief supervisor could learn more about the operations of an insurer and should be able to spot any irregular practices.

D.5.3 Other forms of dispute resolution

Originating in Scandinavia, an Ombudsman is a popular alternative method of resolving disputes. Complaints can be referred to an Ombudsman's Bureau staffed by skilled professionals. It is usually funded by membership fees and/or complaint fees paid by insurers. Sometimes a small fee is paid by complainants. The purpose of the latter is to deter frivolous complaints. Both complainants and insurers usually agree in advance to abide by an Ombudsman's decision but, in some jurisdictions, complainants are also entitled to take a grievance to court if they disagree with an Ombudsman's decision. Arbitration panels perform similar services by providing a means of avoiding expensive litigation. It is becoming increasingly common for all financial services' complaints to be dealt with by a single Ombudsman.

This is because of the blurring of boundaries between the provision of different financial services - eg where banks sell mortgages and endowment insurance packages.

A similar system has been developed in Australia where, following some high profile cases and investigations, separate codes of practice have been developed for both life and general insurance. These codes are mainly self-regulatory and industrial bodies have duties to ensure companies observe the codes. Currently there is a legal requirement that licensed general insurers and brokers agree to comply with an approved code of practice.

These codes set out how insurance companies must handle enquiries, complaints and disputes from their customers. In respect of complaints and disputes they require insurance companies to have an internal disputes handling mechanism, accessible to customers and which is free, operates fairly and deals with disputes promptly. They also demand that insurance companies participate in external disputes handling mechanisms which must meet the following minimum criteria:

- Accessible to all retail customers;
- Free of charge to customers;
- Cover a broad range of complaints;
- Independent from insurers;
- Provide reasons for decisions;
- Has transparent processes (eg publishes its decisions and the reasons behind them) and, finally,
- Companies must be bound by tribunal decisions, but dissatisfied customers can make judicial appeal.

Such external dispute handling mechanisms were established because of the high cost and delay involved when customers try to obtain justice through the

legal system. Dispute handling mechanisms are funded by the industry concerned, but are independent being run by boards which have a majority of independent directors, including consumer representatives and some industry representatives. Each board can have several specialist tribunals which consider disputes by examining written material and oral submissions. These panels are often chaired by retired judges and publish the reasons for their decisions.

SUMMARY

This relatively straightforward section has dealt primarily with the two major regulatory issues involved with supervising agents and brokers. The first is licensing procedures and requirements. The second covers the liabilities to the insured of agents, brokers, and insurers.

The possibility of self-regulatory organizations (SROs), similar to those already found in a number of several countries, was also looked at.

The section also details issues and options relating to foreign brokers and multinational companies.

GLOSSARY OF TERMS (as used in the North American Market)

It is recognized that some jurisdictions will have different terminology or practice.

Abandonment the act of surrendering to the insurer all interest in the subject of the insured: it is generally conceded that property cannot be voluntarily abandoned to the insurance company-one notable exception to this general rule occurs in ocean marine, where abandonment is merely one step in proving a loss

Absolute Liability a legal doctrine under which one can be held liable even in the absence of negligence having been proven, as in the case of workers' compensation (also sometimes called 'No Fault Liability')

Acceptance agreeing to terms by means of which a bargain is concluded and the parties are bound: the binding of an insurance contract by the insurer

Accident an event or occurrence which is unforeseen and unintended

Accident Insurance a form of insurance against loss by bodily injury, incapacity and death caused by accident

Accidental Bodily Injury injury to the body of the insured as the result of an accident

Accidental Death Benefit a provision added to an insurance policy for payment of an additional benefit in case of death by accidental means: it is often referred to as 'double indemnity'

Accidental Means appearing in some policies, the unexpected or undersigned cause of an accident; the 'means' which caused the mishap must be accidental in order to claim policy benefits

Accommodation Risk insurance written for an applicant that would normally be rejected by the insurer, but which is provided as a concession to the agency or a valued insured

Acquisition Cost that portion of an insurance premium which represents the cost of producing the insurance business: it includes the agent's commission, the company field expense, and other related expenses

Actual Cash Value the limit of indemnification under the Standard Fire Policy and other property contracts: in most cases it is replacement cost minus depreciation

Actuary a person professionally trained in the technical aspects of insurance and related fields, particularly in the mathematics of insurance such as the calculation of premiums, reserves, and other values

Additional Interest one who may claim under, or is protected by, an insurance policy issued to another, such as a mortgagee named in a fire policy

Additional Living Expense insurance paying the extra expense involved in living elsewhere during the period of time it is impossible to remain in a dwelling which has been damaged by fire or another insured peril

Adjustment Bureau an organization that contracts with insurers to provide loss settlement services on behalf of those insurers

Adjustable Life Insurance a type of insurance that allows the policyholder to change the plan of insurance, raise or lower the face amount of the policy, increase or decrease the premium, and lengthen or shorten the protection period

Adjuster one who settles insurance claims; may be a salaried employee or an independent operator

Administrator a person authorized to administer the estate of a deceased person by the court: his or her duties are to collect assets of the estate, pay its debts, and distribute the residue to those entitled: he or she resembles an executor, who is appointed by the will of the deceased - the administrator is appointed by the court and not by the deceased and therefore must give security for the administration of the estate, called an administration bond

Admiralty involving maritime law: concerning the high seas or navigable waters

Admitted Assets those assets of an insurer which under state law can be taken into account in representing the financial position of the company

Admitted Company an insurer of another state or country licensed under the laws of a state to do business in that state

Advance Premium Mutual an insurance company owned by its policyholders that charges an advance, or deposit premium that is expected to cover losses and expenses; policies may be assessable or non-assessable

Adverse Selection the tendency of persons with poorer risks or less desirable insureds to seek or continue insurance to a greater extent than do the better risks

Agent in property and casualty insurance, an individual authorized by an insurance company to create, modify, and terminate contracts of insurance or to arrange to do so or to advise on contracts of insurance for certain jurisdictions: in life insurance, a sales and service representative who is also called a 'life underwriter'

Aggregate the greatest total amount recoverable on account of a single loss or during a policy period, or on a single project

Agreed Amount Endorsement a provision in fire insurance whereby the coinsurance clause is suspended if the insured carries an amount of insurance specified by the company (normally 90% or more of the value)

Alien Company an insurance company organized under the laws of a foreign country

Alimony Insurance insurance designed to protect the insured against default in connection with payment of child support and alimony

All-Risk a term commonly used by insurance people to describe broad forms of coverage: it is misleading because no property or liability insurance policy is truly an all-risk coverage. There is a concerted effort to eliminate use of this term and to replace it with the term open peril

Allied Lines a term that has been adopted to refer to the lines of insurance that are allied with property insurance; these coverages provide protection against perils traditionally written by fire companies, such as sprinkler leakage, water damage, and earthquake

American Agency System the term applied to the system of insurance marketing in which the agent is an independent business operator rather than an employee of the company

Amortized Value the amount at a given point in time to which the purchase price of a bond purchased at a discount or premium has been increased or decreased

Annual Statement an insurer's financial report to insurance departments issued at the end of the year or prepared for its financial year for certain jurisdictions. The report is required by the various state insurance departments and is made according to a form agreed upon by the supervising authorities

Annuitant the person during whose life an annuity is payable, usually the person to receive the annuity

Annuity a contract that provides an income for a specified period of time, such as a number of years or for life

Annuity Certain a contract that provides an income for a specified number of years, regardless of life or death, to the insured if living or to his or her beneficiary if deceased

Application a statement of information made by a person applying for life insurance: it is used by the insurance company to determine the acceptability of the risk and the basis of the policy contract

Apportionment a division according to the interests of the various parties herein, as the apportionment clause in a fire policy

Appraisal an estimate of value, loss or damage; see Arbitration

Arbitration the submitting of a matter in dispute to the judgement of a specified number of disinterested persons called 'arbitrators', whose decision, called an 'award' is binding upon the parties

Arson the criminal act of maliciously burning or attempting to burn property

Assault an intentional, unlawful threat of bodily injury to another by force, or force unlawfully directed toward the person of another, under such circumstances as create well-founded fear of imminent peril, coupled with apparent present ability to execute the attempt: battery consists of the actual execution of the act offered in an assault - hence, the placing of the victim in fear (assault) and the actual infliction of the injury (battery) constitute what is commonly referred to as assault and battery

Assessable insurance to which the policyholder may be required to contribute in the event the company becomes unable to pay its losses; confined to certain mutual companies

Assessment a charge sometimes levied against policyholders by certain types of companies

Assessment Mutual an insurance company owned by its policyholders that issues policies under which the policyholders may be assessed for losses and expenses

Assigned Risk an applicant for automobile or workers' compensation insurance declined by one or more companies: such a risk may be assigned to designated companies as directed by recognized authority - the operation is called an 'assigned risk plan'

Assignment the legal transfer of one person's interest in an insurance policy to another person

Assured a person who has been insured by an insurance company or underwriter against loss

Attachment a statutory legal remedy whereby one party may prevent removal of property belonging to another party, pending determination of a court action

Attorney-in-Fact one appointed to act for another: the chief administrative officer of a reciprocal insurance group, who uses his or her power of attorney to commit the members of the group as insurers of each other; also one who executes a surety bond on behalf of the company being represented

Attractive Nuisance a dangerous place, condition or object that is particularly attractive to children: in these cases the courts have frequently held that where 'attractiveness' exists, the owner is under a duty to take steps to prevent injury to those who may be attracted and the owner may be held liable for failure to do so

Audit Premium the additional premium to which the company is entitled or the return premium to which the insured is entitled after an audit and refiguring of the base on which the original or deposit premium was charged

Automatic Premium Loan a provision in a life insurance policy authorizing the company to pay automatically by means of a policy loan any premium not paid by the end of the grace period

Automatic Treaty a reinsurance contract under which risks written by the reinsured are automatically assumed by the reinsurer subject only to the terms and conditions of the treaty

Automobile Insurance Plan a state pool in which each automobile insurer in the state accepts a portion of the undesirable automobile insurance applicants: formerly called 'assigned risk plans'

Automobile Liability Insurance a form of liability insurance that is specifically designed to indemnify for loss incurred through legal liability for bodily injury and damage to property of others caused by accident arising out of ownership or operation of an automobile

Average Clause a coinsurance clause: a clause requiring an insured to purchase insurance for a stipulated portion of the entire value of the thing insured; see General Average; Particular Average

Bailee one who has possession of property belonging to another

Bailment a delivery of goods or personal property by one person to another in trust for the execution of a special object upon or in relation to such goods. Bailment may be for the benefit of the bailee, for the benefit of the bailor, or for mutual benefit. In addition, bailment may be gratuitous or may be a bailment for hire

Bailor the owner of property that has been delivered to and is in the possession of another

Battery any unlawful beating or other wrongful physical violence or constraint inflicted upon a human being without his or her consent; see Assault.

Beneficiary one for whose benefit a contract is made; the person to whom a policy of insurance is payable

Beneficiary, Contingent the person or persons designated to receive the death benefit if the primary beneficiary dies prior to the death of the insured

Beneficiary, Irrevocable a beneficiary that cannot be altered by the insured, the insured having relinquished the right to change the beneficiary designation

Beneficiary, Primary the person or persons designated to receive the benefits under the policy

Betterment an improvement rendering property better than mere repairs would do

Bid a proposal or offer

Binder a written agreement (sometimes oral) whereby one party agrees to insure another party pending receipt of, and final action upon, the application

Binding Receipt in life insurance, a receipt for a premium that accompanies the application for insurance. It binds the company if issuance is approved, to make the policy effective from the date of the receipt

Blanket in property and liability, used to designate insurance that extends to more than one location, or one class of property or one employee

Blanket Medical Expense (accident) a provision for the payment of actual expense of hospital, nurse, surgical, and medical care subject to an overall maximum for all such expense

Blue Cross an independent, nonprofit membership corporation providing protection against the costs of hospital care in a limited geographical area

Blue Shield an independent, nonprofit membership corporation providing protection against the costs of surgery and other items of medical care in a limited geographical area

Bodily Injury physical injury to a person

Boiler and Machinery Insurance coverage for loss arising out of the operation of pressure, mechanical, and electrical equipment; it may cover loss suffered by the boiler and machinery itself and may include damage done to other property, as well as business interruption losses

Bond a written agreement of obligation under seal: the person to whom the undertaking is given is called 'obligee'; the person liable for the undertaking is called the 'obligor' or 'principal': if a third party guarantees performance of the agreement, he is called the 'surety'

Bottomry in the early days of marine insurance, a ship owner would borrow money on a mortgage on the ship, and the mortgage would provide that if the ship were lost, the borrower would not have to repay the loan. This was bottomry, which thus combined money lending with insurance. When cargo instead of hull was involved, it was called 'respondentia'

Breach of Contract failure to comply with the terms or conditions incorporated in an insurance policy, frequently resulting in a restriction of coverage or a voiding of a policy itself

Broker an individual who arranges and services insurance policies on behalf of the insurance buyer: he or she is the representative of the insured, although the broker may receive compensation in the form of a commission from the company

Bureau a cooperative ratemaking body, which is supported by member companies: the member companies agree to abide by the rates published by the bureau

Burglary felonious abstraction of property from within premises by persons making felonious entry by force of which there are visible marks on the exterior

Business Interruption insurance covering the loss of earnings resulting from, and occurring after, destruction of property: also called 'use and occupancy insurance'

Business Life Insurance life insurance purchased by a business enterprise on the life of a member of the firm; it is often bought by partnerships to protect the surviving partners against loss caused by the death of a partner, or by a corporation to reimburse it for loss caused by the death of a key employee

Business Owners' Policy a multiple line package policy for small businesses which includes property and liability coverages

Calendar-year Deductible in health insurance, the amount of expense that must be borne by the insured during a calendar year before the health insurance policy makes payment for loss

Capital Sum a lump sum payable for dismemberment and sight losses

Captive Agent an agent who, by contract, represents only one company and its affiliates

Captive Insurer an insurance company established by a parent firm for the purpose of insuring the exposures of the parent or its affiliates

Cash Surrender Value the amount available in cash upon voluntary termination of a policy before it becomes payable by death or maturity

Cash Value Accumulation Test one of two tests used in determining if a contract is a life insurance policy for the purpose of the Internal Revenue Code: see Cash Value Corridor Test

Cash Value Corridor Test one of two tests used for determining if a contract is a life insurance policy for the purpose of the US Internal Revenue Code: see Cash Value Accumulation Test

Casualty Insurance a classification of insurance coverages used in the monoline era consisting of workers' compensation, liability, crime, glass, and boiler coverages, used to distinguish such coverages from 'fire' or property coverages

Catastrophe Loss a loss of unusual size; a shock loss: a very large loss

Ceding Company a company which has placed reinsurance as distinguished from the company which has accepted the reinsurance

Certified Professional Public Adjuster (CPPA) professional designation granted to public adjusters who pass a rigorous examination and meet specified eligibility requirements

Cession the amount of a risk which the insurance company reinsures: the amount passed on to the reinsurer

Change of Occupation Clause standard provision in health insurance policies which reduces benefit if the insured changes to a more hazardous occupation

Chartered Life Underwriter (CLU) professional designation granted to persons in the life insurance field who pass a series of rigorous examinations and meet specified eligibility requirements

Chartered Property Casualty Underwriter (CCU) professional designation granted to persons in the property and liability insurance field who pass a series of rigorous examinations and meet specified eligibility requirements

Claim notification to an insurance company that payment of an amount is due under the terms of a policy

Claims-made Form a liability insurance policy under which coverage applies to claims made during the policy period: see Occurrence Form

Class Rating an approach to ratemaking in which a price per unit of insurance is computed for all applicants with a given set of characteristics. For example, the rate may apply to all persons of a given age and sex, to all buildings of a certain type of construction, or to all businesses of a certain type

CLU see Chartered Life Underwriter

Coinsurance in property and casualty insurance, clause or provision in an insurance policy requiring a specified amount of insurance based on the value of the property insured; normally, there is a premium reduction for purchasing insurance to some percentage of the value of the property - if the insured fails to comply with the clause, he or she will suffer a penalty in the event of partial loss: in health insurance, a policy provision requiring the insured to share a given percentage of the loss

Collateral Source Rule a legal principle applicable in the area of tort liability, which holds that the plaintiff's measure of damage should not be mitigated by payments received from sources other than the tortfeasor

Collusion a compact between persons usually to the detriment of other persons or for some improper purpose

Combined Ratio a rough indication of the profitability of a property and liability insurer's underwriting operations, generally computed by adding the ratio of losses incurred to premiums earned and expenses incurred to premiums written

Commercial the opposite of personal: of a business nature, usually mercantile or manufacturing

Commercial Paper Insurance a form of credit enhancement insurance that guarantees the timely payment of principal and interest on commercial paper issued by corporations

Commission the fee paid by the insurance companies to agents for the sale of policies

Common Carrier a firm that offers to transport merchandise for hire and must accept shipments from anyone who wishes to use its services. Different laws and rules govern common carriers than do private or contract carriers that only transport the goods of those with whom they have made agreements

Common Law distinguished from law created by enactment of statutes; common law comprises the body of principles and rules of action, relating to the government and security of persons and property, which derive their authority solely from usages and customs of immemorial antiquity, or from the judgments and decrees of the courts

Comparative Negligence a modification of the principle of contributory negligence. In those jurisdictions which follow the principle of comparative negligence, negligence on the part of the injured party will not necessarily defeat the claim, but will be considered in determining the amount of damages

Compensation wages, salaries, awards, fees, commissions, financial returns of any kind

Completed Operations a commercial liability insurance coverage applicable to liability arising out of work performed by the insured after such work has been finished

Comprehensive a loosely used term signifying broad or extensive insurance coverage

Comprehensive General Liability (CGL) a business liability policy that covers a variety of exposures in a single contract

Comprehensive Major Medical Insurance a policy designed to give the protection offered by both a basic and major medical health insurance policy: it is characterized by a low 'deductible' amount coinsurance feature, and high maximum benefits - usually \$100,000-250,000

Comprehensive Personal Liability Insurance a type of insurance that reimburses the policyholder if he or she becomes liable to pay money for damage or injury he or she has caused to others; this form does not include automobile liability but does include almost every activity of the policy holder except business operations

Concealment deliberate failure to reveal material facts that would affect the validity of a policy of insurance

Concurrent covering the same kind of property at the same location under the same terms and conditions, with the same types of coverage, as two or more insurance policies

Concurrent Causation a legal doctrine in property insurance that makes the insurer liable for damage when property is damaged by two causes, one of which is excluded and the other covered

Conditionally Renewable a continuation provision in health insurance under which the insurer may not cancel the policy during its term but can refuse to renew under specified circumstances

Conditions those provisions in insurance contracts that qualify the insurer's promise of indemnity or impose obligations on the insured

Confining Sickness that which confines an individual to his or her home or a hospital (visits to physicians and hospitals are generally considered as not terminating confinement)

Conglomerate a group of corporations engaged in widely varied activities. In the insurance industry a conglomerate refers to a group of companies with noninsurance interests that purchases an insurance company

Consequential Loss loss occurring after, and as a result of, some other loss, as loss of profits resulting from a fire or a loss of frozen foods resulting from electrical failure

Consideration price, token, or other matter used as an inducement for the completion of a contract, as an insurance premium

Constructive Total Loss a loss of sufficient amount to make the cost of salvaging or repairing the property equal to or greater than the value of the property when repaired

Contingent conditional; depending upon another happening - a contingent beneficiary is one next in line after the first named

Contingent Beneficiary in life insurance, a beneficiary who is entitled to receive proceeds if the primary beneficiary has died

Contract Bond a surety bond issued to support the obligation of one who is engaged to perform under a contract

Contractual Liability legal liability assumed under contract

Contribution a participation, as two insurance policies in the same loss

Contribution by Equal Shares an 'other insurance' provision under which two or more policies share equally in a loss until the limit of one policy is exhausted, with the unexhausted policy paying the loss in excess of this amount

Contributory Negligence the lack of ordinary care on the part of an insured person, which combined with the defendant's negligence and contributed the injury as a proximate cause. In some jurisdictions, contributory negligence on the part of an injured party will defeat his or her claim

Convention Blank a report form developed by the National Association of Insurance Commissioners and required by all states, on which insurers file an annual statement of their financial condition with the state regulatory authorities

Conversion wrongful appropriation to one's own use of property belonging to another

Convertible Term Insurance term insurance which can be exchanged, at the option of the policyholder and without evidence of insurability, for another plan of insurance

Co-ordination of Benefits Provision a group health insurance policy provision designed to eliminate duplicate payments and provide the sequence in which coverage will apply when a person is insured under two contracts

Corridor Deductible in health insurance, a deductible under a major medical policy that applies after coverage under a base plan is exhausted

Cosurety a personal or corporate guarantor of a surety obligation on which one or more of the sureties are directly responsible for the same obligation

Counter Signature an additional signature required in most states to comply with resident agency laws; applies when a producer in one state controls business located in, or operating in, another state

Coverage the insurance afforded by the policy

CPCU see Chartered Property Casualty Underwriter

CPPA see Certified Professional Public Adjuster

Credit Enhancement Insurance a form of coverage in which the insurer guarantees the payment of interest and/or principal of the insured in connection with debt instruments issued by the insured

Credit Insurance a form of guarantee to manufacturers and wholesalers against loss resulting from default on the part of debtors

Credit Life Insurance term life insurance issued through a lender or lending agency to cover repayment of a specific loan, instalment purchase, or other obligation in case of the debtor's death

Crime a wrong against public laws or customs punishable by fine, imprisonment, or death after trial in a criminal court

Crop-Hail Insurance protection for monetary loss resulting from hail damage to growing crops

Currently Insured under OASDHI, the status of a worker who has at least six quarters of coverage out of the last thirteen quarters and whose beneficiaries are entitled to 'currently insured' benefits

Daily Report a copy of that portion of an insurance contract dealing with the description of the risk and the amount of insurance, which is sent to the home office of the insurance company and retained in the agent's files

Damages the amount claimed or allowed as compensation for injuries sustained or property damaged through the wrongful acts or the negligence of another; an award

Declarations that part of an insurance policy containing the representations of the applicant

Declination the rejection by a life insurance company of an application for life insurance, usually for reasons of the health or occupation of the applicant

Deductible a provision whereby an insured may be required to pay part of a loss, the insurance being excess over the amount of the deductible

Deferred Annuity an annuity providing for the income payments to begin at some future date, such as in a specified number of years or at a specified age

Deferred Group Annuity a type of group annuity providing for the purchase each year of a paid-up deferred annuity for each member of the group, the total amount received by the member at retirement being the sum of these deferred annuities

Defined Benefit Plan a pension plan in which the retirement benefit is defined and in which the employer's contribution is a function of that benefit

Defined Contribution Plan a pension plan under which the payments into the plan are fixed, but the retirement benefit is variable: also called a money purchase plan

Dental Insurance a type of health insurance that covers dental care expenses

Dependency Period the period during which children will be dependent on a surviving parent

Deposit Administration a type of group annuity providing for the accumulation of contributions in an undivided fund out of which annuities are purchased as the individual members of the group retire

Deposit Premium an original premium paid by the insured at the inception date of the policy: estimated premium, subject to later adjustment: see Audit Premium

Depreciation the lessening of value through age, deterioration, and obsolescence

Deviate to file or use a rate which is based upon but which departs from a standard bureau rate

Difference in Conditions (DIC) Insurance a broad form of open-peril property insurance written as an adjunct to two or more policies that cover named perils, to ensure continuity of cover which might otherwise be excluded by the differences in conditions between the policies

Direct Loss loss resulting directly and immediately from the hazard insured against

Direct Writer an insurance carrier that deals directly with the insured through a salaried representative, as opposed to those carriers which use agents (also used to refer to carriers which operate through exclusive agents); in reinsurance, the company that originally writes the business

Disability inability to perform all or part of one's occupational duties because of an accident or illness: see Total Disability and Partial Disability

Disability Benefit a provision added to a life insurance policy for waiver of premium, and sometimes payment of monthly income, if the insured becomes totally and permanently disabled

Disability Income Insurance a form of health insurance that provides periodic payments to replace lost income when the insured is unable to work because of illness or injury

Discovery Period the period after termination of an insurance policy or bond, or after the occurrence of a loss, within which the loss must be discovered to be covered

Dismemberment accidental loss of limb or sight

Distress Carrier an insurance company specializing in substandard risk, usually in the field of automobile insurance

Dividend in insurance contracts, the refund of a part of the premium paid at the beginning of a year which still remains after the company has made deductions for losses, expenses, and additions to reserves

Dividend Addition an amount of paid-up insurance purchased with a policy dividend and added to the face amount of the policy

Domestic Company a name given to a company in the state of its incorporation, as an Iowa company is domestic in the state of Iowa, foreign as to all other states, and alien as to all other countries

Double Indemnity a provision under which certain benefits are doubled when accident is due to specified circumstances, such as public conveyance accidents: in a life insurance policy, a provision that the face amount payable on death will be doubled if the death is a result of an accident

Dread Disease Policy a limited form of health insurance that pays for treatment of specified diseases such as cancer

Dram-Shop Law a state statute that imposes liability on sellers of alcoholic beverages in the event that the buyer causes bodily injury to another or in some cases, to himself or herself

Earned Premium premium for which protection has been provided. When a premium is paid in advance for a policy period, the company 'earns' a portion of that premium only as time elapses during that period

Effective Date the date upon which the policy is put in force, the inception date

Effective Benefit a benefit payable in lieu of another (e.g. a lump sum benefit may be allowed for specified fractures or dislocations in lieu of weekly indemnity)

Eligibility Period in group insurance, a period during which group members may enroll in the plan without providing evidence of insurability

Elimination Period see Waiting Period

Employee Retirement Income Security Act (ERISA) a 1974 federal statute that establishes minimum standards for pension plans

Employer's Liability legal liability imposed on an employer making him or her responsible to pay damages to an employee injured by the employer's negligence. Generally, replaced by 'workers compensation', which pays the employee whether the employer has been negligent or not

Endorsement a written amendment affecting the declarations, insuring agreements, exclusions, or conditions of an insurance policy: a rider

Endowment Insurance insurance payable to the insured if he or she is living on the maturity date stated in the policy, or to a beneficiary if the insured dies prior to that date

Environmental Impairment Liability (EIL) liability arising out of pollution

Equipment Value Insurance (EVI) insurance assigned to protect businesses against a decline in the value of certain types of property

Equivalent Level Annual Dividend the average of annual life insurance policy dividends for a specified period, adjusted for interest at a specified rate

Errors and Omissions Insurance professional liability insurance for individuals in professions such as accounting, insurance, law, or real estate, where the exposure is primarily a property damage one as opposed to bodily injury

Estate possessions of a deceased person; possessions of a minor or incompetent person; possessions of a bankrupt person or corporation; worldly goods of anyone

Estoppel an admission or declaration by which a person is prevented from proving the contrary

Excess that which goes beyond, as excess insurance, over and above a primary amount

Excess of Loss Reinsurance a form of reinsurance whereby the reinsuring company reimburses the ceding company for the amount and only the amount of loss the ceding

company suffers over and above an agreed aggregate sum in any one loss or in a number of losses arising out of any one event

Exclusion that which is expressly eliminated from the coverage of an insurance policy

Exclusive Agency System an insurance marketing system under which the agent represents a single company or company group

Expectation of Life (life expectancy) the average number of years of life remaining for persons of a given age according to a particular mortality table

Expected Loss Ratio the percentage of the final rate allocated for the payment of losses

Expense Ratio the proportionate relationship of an insurer's expenses to premium expressed as a percentage

Experience Rating an insurance pricing system in which the insured's past experience determines the premium for the current protection

Expiration the date upon which an insurance policy terminates unless continued or renewed by an additional premium

Exposure unit of measurement to which an insurance rate is applied

Extended Coverage Insurance protection for the insured against loss or damage of his property caused by windstorm, hail, smoke, explosion, riot, riot attending a strike, civil commotion, vehicle and aircraft: this is provided in conjunction with the fire insurance policy

Extended Term Insurance a form of insurance available as a nonforfeiture option; it provides the original amount of insurance for a limited period of time

Extended Unemployment Insurance Benefits additional unemployment benefits under a state-federal programme payable during periods of high unemployment to workers who have exhausted their regular benefits

Extra Expense Insurance a form of indirect loss property insurance that pays for the increased costs of continuing operations following damage to property by an insured peril

Face Amount the amount stated on the face of a life insurance policy that will be paid in case of death or at the maturity of the contract; it does not include dividend additions, or additional amounts payable under accidental death or other special provisions

Factory Mutuals a group of mutual companies, principally located in New England, specializing in the insurance of manufacturing properties

Facultative Reinsurance reinsurance effected item by item and accepted or declined by the reinsuring company after scrutiny as opposed to reinsurance effected by treaty

FAIR Plan - Fair Access to Insurance Requirements state pools designed to provide insurance to property owners who are unable to obtain property insurance because of the location of their property or other factors over which they have no control

Family Income Policy a life insurance policy, combining whole life and decreasing term insurance, under which the beneficiary receives income payments to the end of a specified period if the insured dies prior to the end of the period, and the face amount of the policy either at the end of the period or at the death of the insured

Family Maintenance Policy life insurance which pays, in addition to the face of the policy, a monthly income for a period commencing with the insured's death and continuing for the number of years specified; the period is most often 10, 15, or 20 years

Family Policy a life insurance policy providing insurance on all or several family members in one contract, generally whole life insurance on the wage earner and smaller amounts of term insurance on the spouse and children, including those born after the policy is issued

Family Purpose Doctrine a legal doctrine that imposes vicarious liability on the head of the family for operation of a family car by family members

Federal Crime Insurance Program a programme administered by the Federal Insurance Administration which provides for the sale of Federal Crime insurance in any state where adequate and affordable crime insurance is not available

Federal Flood Insurance a federally subsidized flood insurance programme enacted in 1968 under which flood insurance is available in areas that meet specific conditions

Federal Insurance Administration a government office responsible for the supervision of insurance programmes such as the Federal Riot Reinsurance Programme, Federal Flood Insurance Plan, and Federal Crime Insurance Program

Fellow Servant one who serves and is controlled by the same employer; also those engaged in the same common pursuit under the same general control

Fellow Servant Rule rule that a master is not liable for injuries to a servant caused by the negligence of a fellow servant engaged in the same general business and where the master has exercised due care in the selection of servants

Fidelity Bond a contract of fidelity insurance: a guarantee of personal honesty of the person furnishing indemnity against defalcation or negligence; a form of insurance or suretyship which protects a party against loss from the dishonesty of employees

Fiduciary a person or corporation having the duty created by undertaking to act primarily for another's benefit in matters connected with such undertaking, or an agent handling the business of another when the business he or she transacts or the money or property being handled is not his or her own or for his or her own benefit

Field Supervisor a salaried employee of an insurance company whose responsibilities are (a) production of new business through existing agents, (b) the appointment of new agents, (c) general supervision of the company's affairs in his territory

File and Use Law a system of rate regulation in which rates may be used immediately by an insurer once they are filed with the state regulatory authority. The supervisory authority may later disapprove and rescind the rates

Financial Guarantee Insurance a form of coverage in which the insurer guarantees the payment of interest and/or principal of the insured in connection with debt instruments issued by the insured

Financial Responsibility Law a statute which requires motorists to show evidence of financial responsibility following an accident which involves bodily injury or property damage in excess of some amount: normally, proof of financial responsibility is given through a valid policy of insurance

Fire as used in insurance contracts, combustion proceeding at a rate rapid enough to generate a flame, glow, or incandescence

Fire Insurance coverage for losses caused by fire and lightning, as well as the resultant damage caused by smoke and water

Fire Legal Liability a form of liability insurance that covers damage to leased or rented property caused by fire or other specified perils

Fleet a group, as of automobiles

Floater a marine or fire policy, the coverage of which follows the movement of the property insured

Flood overflow of water from its natural boundaries. More specifically defined by the National Flood Act of 1968 as 'a general and temporary condition of partial or complete inundation of normally dry land areas from (1) the overflow of inland or tidal waters or (2) the unusual and rapid accumulation or runoff of surface waters from any source'

Foreign Insurer an insurance company that is chartered in another state

Franchise Insurance a class of life insurance in which individual policies are issued to members of a group, with an employer or other body collecting and/or remitting the premiums

Fraternal Insurance certain fraternal organizations have a form of cooperative life or disability insurance that is available to members of the fraternal organization

Friendly Fire a fire confined to the place it is supposed to be in (e.g. in a stove or similar place)

Fully Insured under OASDHI, the status of a worker who has 40 quarters of coverage or one quarter of coverage for each year after 1950 or after age 21, if later, and who is entitled to 'fully insured' benefits

General Average in marine insurance, a loss that must be borne partly by someone other than the owner of the goods that were lost or destroyed: for example, if it is necessary to jettison cargo to save a ship, the owners of the ship and the rest of the cargo that is saved will share in the loss of the goods that were intentionally sacrificed

General Damages amounts awarded in litigation to compensate for pain and suffering and other non-economic loss

Grace Period the period of time following the due date of a policy premium during which the payment of the premium will continue the policy and during which the policy is in full force and effect

Graded Commission a reduced commission justified by the size of the premium

Graded Expense a reduced expense item for the insurance company justified by the size of the premiums

Gross Premium the premium for insurance that includes the provision for anticipated losses (the pure premium) and for the anticipated expenses (loading)

Group Annuity a pension plan providing annuities at retirement to a group of persons under a single master contract, with the individual members of the group holding certificates stating their coverage; it is usually issued to an employer for the benefit of employees - the two basic types are 'deferred' and 'deposit administration' group annuities

Group Insurance any insurance plan under which a number of employees and their dependants are insured under a single policy, issued to their employer, with individual certificates given to each insured employee; the most commonly written lines are life and accident and health

Guaranteed Renewable Policy a policy which the insured has the right to continue in force by the timely payment of premiums to a specified age (usually age 50), during which period the insurer has no right to make unilaterally any change in any provision of the policy while the policy is in force, but may make changes in premium rates by policyholder class

Guest Laws state statutes which limit the right of action of an injured guest passenger in an automobile against the driver to instances of gross negligence or wilful and wanton negligence

Hazard a condition that creates or increases the probability of a loss

Hazard, Moral the chance that a loss may be caused by, or due to a lack of character or integrity on the part of the insured

Health Insurance a generic term applying to all types of insurance indemnifying or reimbursing for losses caused by bodily accident or sickness or for expenses of medical treatment necessitated by sickness or accidental bodily injury

Health Insurance Association of America a voluntary, nonprofit association of companies organized for the purpose of promoting 'the development of voluntary health insurance providing sound protection against loss of income and other financial burdens resulting from sickness or accidental bodily injury'

Health Maintenance Organization (HMO) a prepaid medical group practice plan for the provision of health care, in which individual subscribers pay an annual fee in return for entitlement to a wide range of health services. HMOs are both insurers and providers of health care

Hold-Harmless Agreement a contract usually written whereby one party assumes legal liability on behalf of another party

Hostile Fire a fire burning where none is intended

Hull Insurance in ocean marine and aviation insurance, coverage for physical damage to a vessel or aircraft

Immediate Participation Guarantee (IPG) Plan a type of insured pension plan under which gains and losses from mortality or investments are segregated from the rest of the insurer's operations and credited directly to the employer's account

Improvements and Betterments Insurance insurance that protects a tenant against loss to improvement made by him or her to property in which he or she is a tenant

Incontestable Clause a provision that prevents the carrier from challenging the coverage because of alleged misstatements by the insured after a stipulated period has passed, usually two or three years

Incurred Losses losses actually sustained during a fixed period, usually a year. Incurred losses are customarily computed by the formula: losses paid during the period, plus outstanding losses at the end of the period, less outstanding losses at the beginning of the period

Indemnity, Principle of a general legal principle related to insurance which holds that the individual recovering under an insurance policy should be restored to the approximate financial position he or she was in prior to the loss

Independent Adjuster one who adjusts losses on behalf of companies but is not employed by any one. He or she is paid by fee for each loss adjusted

Independent Agent a person operating under the American Agency System, representing several property and liability insurers, and dividing the policies he or she writes among the various companies represented

Independent Contractor one who performs work for another in his or her own manner and method, and who is not subject to the control or direction of the party for whom the work is performed: he or she is not an employee of the party for whom the work is performed

Indeterminate Premium Life Insurance life insurance in which the premium may be adjusted upward or downward after inception, subject to a maximum premium stated in the policy

Indirect contingent: that which happens only after something else has occurred

Individual Policy Pension Trust a type of pension plan, frequently used for small groups, administered by trustees who are authorized to purchase individual level premium policies or annuity contracts for each member of the plan: the policies usually provide both life insurance and retirement benefits

Individual Retirement Account (IRA) a tax sheltered retirement plan established by an individual under which earnings accumulate tax free until distributed. Contributions up to \$2,250 are deductible for some persons

Industrial Development Bond Insurance insurance designed to guarantee prompt payment of principal and interest on industrial development bonds

Industrial Life Insurance life insurance issued in small amounts, usually less than \$1,000, on a single life exclusive of additional benefits, with premiums payable on a monthly or more frequent basis, and generally collected at the insured's home by an agent of the company

Inherent Vice a characteristic depreciation such as the fading of ink, a cracking of parchment, the greying of hair

Inland Marine Insurance a broad type of insurance, generally covering articles that may be transported from one place to another; the essential condition is that the insured property be movable, though bridges, tunnels, and similar instrumentalities of transportation are also considered inland marine: this form of insurance was developed originally by marine underwriters to cover goods while in transit by other than ocean vessels: it now includes any goods in transit (generally excepting transocean) as well as numerous 'floater' policies such as personal effects, personal property, jewellery, furs, fine arts, and others

Insolvency Fund state plans created by law to guarantee payment of liabilities of insolvent insurers

Inspection an examination by those having authority: right usually reserved by an insurance company with respect to any property it insured

Insurable Interest an interest which might be damaged if the peril insured against occurs: the possibility of a financial loss to an individual which can be protected against through insurance

Insurance an economic device whereby the individual substitutes a small certain cost (the premium) for a large uncertain financial loss (the contingency insured against) which would exist if it were not for the insurance contract: an economic device for reducing and eliminating risk through the process of combining a sufficient number of homogeneous exposures into a group in order to make the losses predictable for the group as a whole

Insurance Purchasing Group a group of firms or other organizations that band together under the provisions of the Risk Retention Act of 1986 for the purpose of buying insurance collectively

Insurance Regulatory Information System (IRIS) a computerized model designed by the National Association of Insurance Commissioners for the detection of potential insurer insolvencies before they occur through analysis of selected audit ratios

Insurance Services Office (ISO) the principal ratemaking organization for property and liability insurers

Insured in life insurance, the person on whose life an insurance policy is issued: in property and liability insurance, the person to whom or on whose behalf benefits are payable under the policy

Interest-Adjusted Method a means of measuring differences in cost among life insurance policies that considers the time value of money

Intestate leaving no will at death

Invitee a person having an express or implied invitation to enter a given location

Irrevocable Beneficiary a beneficiary designation that may be changed only with the consent of the beneficiary

Joint Insured one of two or more persons whose names or interests are insured under the same or identical contracts

Joint-and-Last Survivor Annuity an annuity issued on two lives under which payments continue in whole or in part until both have died

Joint-Life Annuity an annuity issued on two lives under which payments cease at the death of either of the two persons

Joint Underwriting Association (JUA) a loss sharing mechanism used in some states to provide insurance to high-risk drivers

Judgment the decision of a court or the reason for such decision

Judgment Rating the process of determining the rate for a coverage without the benefit of extensive loss experience or statistical information

Judicial Bond a surety bond required in court proceedings

Jumbo Risk a risk requiring exceptionally high benefit limits

Jumping Juvenile Insurance permanent life insurance on children under which the face amount automatically increases to a multiple of the initial amount when the child reaches a specified age

Keogh Plan a tax-qualified retirement plan for self insured individuals similar in most respects to qualified corporate pensions

Key-Persons Insurance a life insurance programme designed to cover the key employees of an employer; it may be written on a group or individual policy basis

Lapse termination of a policy due to failure by the insured to pay the premium as required

Lapsed Policy a policy discontinued for nonpayment of premiums: the term is technically limited to a termination occurring before a life insurance policy has a cash or other nonforfeiture value

Last Clear Chance an exception to the doctrine of contributory negligence that makes a person who has a final opportunity to avoid an accident and fails to do so legally liable

Law of Large Numbers the theory of probability that is the basis for insurance; the larger the number of exposure units, the more closely will the actual results obtained approach the probable results expected from an infinite number of exposures

Leasehold Interest an intangible use interest that exists when the provisions of a lease stipulate a rental that is greater or less than the prevailing market price of renting similar facilities

Legal Reserve Life Insurance Company a life insurance company operating under state insurance laws specifying the minimum basis for the reserves the company must maintain on its policies

Level Premium Insurance life insurance for which the cost is distributed evenly over the premium paying period; the premium remains constant from year to year, and is more than the actual cost of protection in the earlier years of the policy and less than the actual cost in the later years - the excess paid in the early years accumulates the reserve

Liability a debt or responsibility: an obligation which may arise by a contract made or by a tort committed

Licence and Permit Bond a surety bond required of persons who obtain certain licences and permits which guarantees that the individual will comply with laws and regulations pertaining to the licence or permit

Licensee a person on one's property with stated or implied permission but not to further the purposes of the landholder. The property owner is obligated to warn a licensee of any dangers the licensee might not be expected to know about

Life Annuity a contract that provides an income for the life of the annuitant

Lifetime Disability Benefit a benefit for loss of income payable as long as the insured is totally disabled, even for life

Limited Payment Life Insurance a form of whole life insurance on which premiums are payable for a specified number of years less than the period of protection, or until death if death occurs before the end of the specified period

Limited Policies those that cover specified accidents or sickness

Limits the value or amount of a policy: the greater amount that can be collected under the policy

Livery in automobile insurance, the carrying of passengers for hire

Lloyd's a voluntary unincorporated association of individuals organized for the purpose of writing insurance; normally refers to Lloyd's of London, a group of individual underwriters and syndicates that underwrite insurance risks severally, using facilities maintained by the Lloyd's of London Corporation

Loading that part of an insurance rate designed to cover expenses, profit, and a margin for contingencies. In some instances, an additional amount added to an insurance rate because of some extraordinary hazard or expense

Local Agent a producer of insurance whose activities are purely of local extent

Long-Term Disability a generally accepted period of time for more than two years - can vary according to company standards

Loss the unintentional decline in, or disappearance of, value due to a contingency

Loss Frequency the number of claims on a policy during a premium period

Loss Ratio the proportionate relationship of incurred losses to earned premiums expressed as a percentage

Loss Reserves an estimated liability in an insurer's financial statement, indicating the amount the insurer expects to pay for losses that have taken place but which have not yet been paid

Losses Incurred But Not Reported (IBNR) losses resulting from accidents which have taken place but on which the company has not yet received notice or report of the loss

Major Medical Expense Insurance policies especially designed to help offset the heavy medical expenses resulting from catastrophic or prolonged illness or injury: they provide benefit payments for 75-80% of all types of medical treatment by a physician above a certain amount first paid by the insured person and up to the maximum amount provided by the policy - usually \$100,000, \$250,000, or higher

Malpractice alleged professional misconduct or lack of ordinary skill in the performance of a professional act. A practitioner is liable for damage or injuries caused by malpractice

Manual a book of rates, rules, and coverages usually available for each kind of insurance

Marine pertaining to the sea or to transportation: usually divided as to 'ocean marine' and 'inland marine'; the insurance covering transportation risks

Mass Merchandising the sale of group property and liability insurance, generally through an employer

Material Fact information about the subject of insurance that if known would change the underwriting basis of the insurance, and which would cause the insurer to refuse the application or charge a higher rate

Medical Information Bureau (MIB) an organization to which life insurers report health impairments of applicants for life insurance; the information is then available to member companies for underwriting purposes

Medical Payments an additional coverage included in some liability contracts under which the insurer agrees to reimburse injured persons for medical expenses

Medicare hospital and medical expense insurance provided under the Social Security system

Miscellaneous Hospital Expense a provision for the payment on a blanket basis or schedule basis of hospital services (other than room and board, special nursing care, and doctors' fees) up to a stipulated maximum amount

Misrepresentation a misstatement: if done with intent to mislead, it may void the policy of insurance

Misstatement of Age Clause in life and health insurance, a policy provision requiring an adjustment in the amount of insurance when the insured has misstated his or her age

Modified Whole Life a form of whole life insurance with a lower than usual initial premium that increases after three to five years

Money Market Fund Insurance private insurance that protects insured investors in a money market mutual fund against loss in the event the fund fails or the issuers of investments held by the fund default

Moral Hazard a dishonest predisposition on the part of an insured which increases the chance of loss

Moral Hazard a careless attitude on the part of an insured that increases the chance of loss or causes losses to be greater than would otherwise be the case

Morbidity Tables actuarial statistics showing the incidence and duration of disability

Mortality Table a statistical table showing the probable rate of death at each age, usually expressed as so many per thousand

Mortgage a deposit or conditional transfer to secure the performance of some act: the person who makes the transfer is called the 'mortgagor', the other party, the 'mortgagee'; sometimes an intermediary called a 'trustee' is appointed

Multiple-Line Insurance policies that combine many perils previously covered by individual policies of fire and liability companies: the homeowner's policy is one example: other examples are the commercial property policy, the farmowner's policy, and the special multiperil policy, for motels and apartments

Municipal Bond Guarantee Insurance a form of coverage sold to municipalities under which the insurer guarantees the payment of interest and principal on bonds issued by the municipality

Municipal Lease Insurance a form of coverage sold to municipalities that assures the municipality's lessors the prompt payment of principal and interest on municipal lease financing

Mutual Insurance Company a nonprofit insurance carrier, without capital stock, that is owned by the policyholders: it may be incorporated or unincorporated

Named Insured the person designated in the policy as the insured as opposed to someone who may have an interest in a policy but not be named

Named Peril Coverage property insurance that covers losses that result from specifically named causes: see Open Peril Coverage

National Association of Insurance Commissioners a national organization of state officials who are charged with the regulation of insurance: although the organization has no official power it exerts a strong influence through its recommendations.

Nationwide Marine Definition a classification of insurance coverages developed by the National Association of Insurance Commissioners to delineate marine insurance from other lines of insurance

Negligence failure to exercise the degree of care that would be expected from a reasonable and prudent person

Net Payment Cost Index in life insurance a measure of cost of a life insurance maintained in force until death, with allowance for interest at some rate

Net Retention the final amount of insurance retained by the company after reinsuring such amounts as it did not wish to retain

No Fault Insurance a form of first party insurance written in conjunction with a no-fault law. Under a no-fault law, the person causing injury is granted immunity from tort action and the person causing injury is granted immunity from tort action and the person injured must collect for his or her loss from his or her own insurer

Nonadmitted Carriers an insurer that has not been licensed to write insurance in a given jurisdiction

Noncancellable or Noncancellable and Guaranteed Renewable Policy a continuous term health insurance policy that guarantees the insured the right to renew for a stated number of years or to a stated age (usually 60 or 65), with the premium at renewal guaranteed

Nonconcurrency a condition that exists when two or more policies covering the same property are written subject to different provisions

Nonconfining Sickness a sickness that does not confine the insured to his or her home or a hospital

Noncontributory Plan a group insurance or pension programme under which the employer pays the entire cost

Nondisabling Injury an injury which does not cause total or partial disability

Nonforfeiture Option privilege available to the policyholder based upon his or her interest in the contract or once cash value has been created

Nonoccupational Policy one that does not cover loss resulting from accidents or sickness arising out of or in the course of employment or covered under any worker's compensation law

Nonparticipating Insurance policy insurance on which the premium is calculated to cover as closely as possible the anticipated cost of the insurance protection and on which no dividends are payable to the insured

Obligee the person in favour of whom some obligation is contracted, whether such obligation be to pay money, or to do, or not do something; the party to whom a bond is given

Obligor the person who has engaged to perform some obligation: one who makes a bond: the bonding company

Occupational Disease a disease or condition of health resulting from performance of an occupation such as psittacosis, mercury poisoning, dust collection in the lungs, and the like: in most states occupational disease is now covered as part of the workers' compensation exposure

Occupational Safety and Health Act of 1970 (OSHA) a federal statute establishing safe and healthy working conditions on a nationwide basis. The act sets job safety and health standards enforced by Labor Department safety inspectors and also provides for compilation of relevant statistics on work injuries and illnesses

Occurrence a happening that occupies some length of time, such as an individual catching cold after sitting in a draught in a theatre all evening; sometimes a series of accidents; see Accident

Occurrence Form a liability insurance policy under which coverage applies to injuries or damage sustained during the policy period, regardless of when the claim is made; see Claims-made Form

Ocean Marine Insurance coverage on all types of vessels, including liabilities connected with them, and on their cargoes: the cargo coverage has been expanded to protect the owners from warehouse to warehouse, inclusive of all intermediate transit by rail, truck, or otherwise

Omnibus Clause archaic term formerly used to refer to a provision in liability contracts that extends coverage to other persons not named in the policy

Open Form a continuous policy written on a reporting basis

Open Peril a term used to describe a broad form of property insurance in which coverage applies to loss arising from any fortuitous cause other than those perils or causes specifically excluded. This is in contrast to other policies which name the peril or perils insured against: see All-Risk

Optionally Renewable in health insurance, a contract in which the insurer reserves the right to terminate coverage at an anniversary or premium-due date

Ordinary Life Insurance a form of whole life insurance usually issued in amounts of \$1,000 or more with premiums payable on an annual, biannual, quarterly, or monthly

basis to the death of the insured or to the end of the mortality table employed, whichever occurs first and at which time (benefits) proceeds are due; the term is also used to mean straight life insurance

Outage Insurance a boiler and machinery consequential loss coverage covering loss during the period a specified object is inoperable as a result of an accident

Ownership of Expiration exclusive right on the part of a property and casualty insurance agent operating under the American Agency System to the records of dates and details of expiring policies

P & I Insurance see Protection and indemnity

Package Policy a combination of the coverages of two or more separate policies into a single contract

Paid-up Insurance insurance on which all required premiums have been paid; the term is frequently used to mean the reduced paid-up insurance available as one of the non-forfeiture options

Parol Evidence Rule when the parties to a contract have purported to embody their contract in writing, that writing is the contract and all of the contract; therefore no evidence is admissible to prove any terms of the contract different from, or in addition to, those set forth in writing

Partial Disability a provision generally found in accident and occasionally in sickness policies designed to offer some weekly or monthly indemnity benefit if the insured cannot perform all the important daily duties of his occupation

Participating Insurance policies that entitle the policyholder to receive dividends reflecting the difference between the premium charged and the actual operating expenses and mortality experience of the company; if expenses and mortality are better than anticipated so that an excess of premium has been collected, a portion of the excess then so available is returned to the insured in the form of dividends - the premium is calculated to provide some margin over the anticipated cost of the insurance protection

Particular Average a term meaning an accidental and usually a partial loss suffered by one interest and not chargeable against others; see General Average

Paul vs. Virginia a U.S. Supreme Court decision of 1869 in which the court ruled that insurance was not commerce and therefore not interstate commerce, thereby exempting the industry from federal control. This decision was reversed in the South Eastern Underwriters Association case of 1944.

Payor Benefit a provision generally included in juvenile life insurance policies waiving future premiums if the payor (usually the parent who pays the premium on the policy) becomes disabled or dies before maturity of the policy

Penalty the limit of an insurer's or surety's liability under a fidelity or surety bond

Percentage Participation Clause in health insurance, a provision that requires the insured to bear a percentage of expenses in excess of the deductible; also called coinsurance

Peril the event insured against; the cause of possible loss

Permanent Life Insurance a phrase used to cover any form of life insurance except term; generally insurance, such as whole life or endowment, that accrues cash value

Permissible Loss Ratio the maximum percentage of premium income that can be expended by the company to pay claims without loss of profit

Personal Auto Policy a simplified language automobile policy designed to insure private passenger automobiles and certain types of trucks owned by an individual or husband and wife

Personal Injury in law, a term used to embrace a broad range of torts that includes bodily injury, libel, slander, discrimination and similar offences. Also a standard insurance coverage that protects against a more limited group of torts (false arrest, detention or imprisonment, malicious prosecution, wrongful entry or eviction, and libel, slander, or defamation)

Physical Hazard a condition of the subject of insurance which creates or increases the chance of loss, such as structural defects, occupancy, or similar conditions

Plaintiff a party to a lawsuit who brings charges against another party called the defendant

Policy the written contract of insurance that is issued to the policyholder insured by the company insurer

Policy Dividend a refund of part of the premium on a participating life insurance policy reflecting the difference between the premium charged and actual experience

Policy Fee an additional charge placed on the initial premium designed to offset a portion of the expense of policy issuance

Policy Loan a loan made by an insurance company to a policyholder on the security of the cash value of his policy

Policy Period the term for which insurance remains in force, sometimes definite, sometimes not

Policy Reserve the amounts that a life insurance company allocates specifically for the fulfillment of its policy obligations: reserves are so calculated that, together with future premiums and interest earnings, they will enable the company to pay all future claims

Policyholder's Surplus total capital funds as shown in an insurer's annual statement. Consists of capital, if any, unassigned funds (surplus) and any special funds which are not in the nature of liabilities

Pollution the contamination of the environment that includes air pollution, noise pollution, water pollution, and disposal of waste materials

Pool a risk sharing mechanism in which the members of a group agree to be collectively responsible for losses

Postselection Underwriting an insurer's practice of re-evaluating the desirability of insureds at or prior to the renewal of their policies

Preauthorized Cheque Plan a plan by which a policyholder arranges with his bank and insurance company to have his premium payments drawn, usually monthly, from his current account

Pre-existing Condition a physical condition that existed prior to the effective date of the policy

Preferred Provider Organization (PPO) a health care delivery organization composed of physicians, hospitals, or other health care providers that contracts with subscribers to provide health care services at a reduced fee

Premises and Operations a commercial liability coverage that protects against liability arising out of the ownership or maintenance of premises or out of the activities of employees away from the premises

Premium the payment, or one of the periodical payments, a policyholder agrees to make for an insurance policy

Premium Loan a policy loan needed for the purpose of paying premiums

Premium Period the length of time covered by the premium, usually identical with the policy period but frequently not

Prepaid Group Practice Plan a plan under which a person pays in advance for the right to specified health services performed by participating physicians and institutions

Primary basic, fundamental: an insurance policy which pays first with respect to other outstanding policies

Primary Beneficiary the individual first designated to receive the proceeds of an insurance policy: see Contingent Beneficiary

Principal the applicant for, or subject of, insurance; the one from whom an agent derives his or her authority

Principal Sum a term used to refer to the lump sum amount payable for accidental death, dismemberment, or loss of sight

Prior Approval Law a system of rate regulation in which rates must be filed with the state regulatory authority and approved before they may be used

Private Insurance voluntary insurance programmes available from private firm or from the government by which an individual may obtain protection against the possibility of loss due to a contingency

Pro Rata Apportionment a division of loss according to the interest of the various companies providing insurance: thus, if Company A has insured the property involved for \$10,000 and Company B has insured the property for \$20,000, Company A will pay one-third of any loss and Company B will pay two-thirds

Pro Rata Cancellation cancellation with a return of premium charged for the period of time the policy was in force equal to the ratio of the total premium to the total policy period; see Short Rate Cancellation

Pro Rata Distribution Clause a clause that provides that the face amount of the insurance will be divided between the objects insured in the proportion that the value of each bears to the value of all

Probationary Period (also sometimes called 'waiting period') a period of time from the policy date to a specified date, usually 15-30 days, during which no sickness coverage is effective: it is designed to eliminate a sickness actually contracted before the policy went into effect - occurs only at the inception of a policy

Producer an agent for an insurance company

Prohibited Risks those not written by a company because of an unusual occupational exposure or uninsurable physical or moral conditions

Proof the act of substantiating another act, such as a claim for insurance payment

Proposal an application for insurance or the facts contained in it; a recommendation

Prorate Clause in health insurance, an optional policy provision designed to protect the company when an insured changes to a more hazardous occupation and does not have his or her policy amended accordingly: the company may pay out such portion of the indemnities provided as the premium paid would have purchased at the higher classification, subject to the maximum limits filed by the company for such more hazardous

occupation; it also protects the insured when he or she changes to a less hazardous occupation by providing for a return premium

Protection and Indemnity (P & I) Insurance shipowner's liability insurance coverage in an ocean marine insurance

Provisions the terms or conditions of an insurance policy

Proximate Cause the immediate or actual cause of loss under an insurance policy

Public Adjuster one who represents the policyholder instead of the company

Public Guarantee Insurance Programmes compulsory quasi-social insurance programmes designed to protect lenders, investors, or depositors against loss in connection with the failure of a financial institution or other type of fiduciary: for example. the Federal Deposit Insurance Corporation

Public Law 15 an historic piece of legislation passed by Congress in 1945 whereby insurance was exempted from the operation of federal antitrust laws 'to the extent that it is regulated by the various states.' Certain other restrictions were added such as a prohibition of coercion: also known as the 'McCarran Act'

Punitive Damages damages awarded separately and in addition to the compensatory damages, usually on account of malicious or wanton misconduct, to serve as a punishment for the wrongdoer and possibly as a deterrent to others

Pure Premium that part of the premium which is sufficient to pay losses and loss adjustment expenses but not including other expenses. Also, the premium developed by dividing losses by exposure disregarding any loading for commission, taxes and expenses

Pure Risk a condition in which there is the possibility of loss or no loss only

Quota Share Reinsurance a reinsurance contract which reinsures an agreed fraction of every risk of the kind described in the contract, which the ceding company writes

Rate the cost of a unit of insurance

Rated Policy an insurance policy issued at a higher than standard premium rate to cover the extra risk involved in certain instances where the insured does not meet the standard underwriting requirements; for example, impaired health or a particularly hazardous occupation

Rating Bureau an organization that makes rates that companies charge for their policies

Realty real property: real estate

Rebate the improper return of part or all of a premium to a policyholder

Reciprocal Exchange an association of individuals who agree to exchange insurance risks - each member of the association insures each of the other members and in turn is insured by each of the other members: see Attorney-in-fact

Recurring Clause a period of time during which a recurrence of a condition is considered as being a continuation of a prior period of disability or hospital confinement

Reduced Paid-up Insurance a form of insurance available as a nonforfeiture option: it provides for continuation of the original insurance plan, but for a reduced amount

Refund Annuity an annuity that provides that the difference between the original cost and payments made to the annuitant will be paid to a beneficiary

Regional Agent a district agent: the grade between local and general agent

Regular Medical Expense Insurance coverage for services such as doctor fees for non-surgical care in the hospital or at home, X-rays or laboratory tests

Reimbursement Benefits those for which the insured is reimbursed on an actual expense incurred basis

Reinstatement the restoration of a lapsed policy

Reinsurance insurance placed by an underwriter in another company to cut down the amount of the risk assumed under the original insurance

Relation of Earnings to Insurance Clause in disability insurance, a provision that reduces payment to the proportion of policy benefits that the insured's earnings at the time of disability (for average earnings for two years prior to disability) bear to total disability benefits under all policies: also called the average earnings clause

Release a discharge, as from further liability under an insurance policy

Renew to continue; to replace, as with new policy

Renewable at Insurer's Option in health insurance, a continuance provision that reserves to the insurer the right to refuse to renew the contract

Renewable Term Insurance term insurance that can be renewed at the end of the term, at the option of the policyholder, and without evidence of insurability, for a limited number of successive terms; the rates increase at each renewal as the age of the insured increases

Rental Value Insurance insurance arranging to pay the reasonable rental value of property which has been rendered untenable by fire or some other peril insured against, for the period of time that would be required to restore the property to tenantable condition

Replacement Cost Insurance property insurance that pays for damaged or destroyed property without a deduction for depreciation

Reporting Form insurance that depends upon regular reports from the insured to determine the amount of insurance or the premium or both

Representation statements made by an applicant in the application that he represents as being substantially true to the best of his or her knowledge and belief, but which are not warranted as exact in every detail

Res ipsa loquitur (the thing speaks for itself) rebuttable presumption that the defendant was negligent: the presumption arises upon proof that the instrumentality causing the injury was in the defendant's exclusive control, and that the accident is one which ordinarily does not happen in the absence of negligence

Reserve liability set up for particular purposes

Residual Disability Benefit a provision in disability income policies that grants benefits based on a reduction in earnings, as opposed to inability to work full time

Residual Market Plan a mechanism through which high-risk insureds who cannot obtain insurance through normal market channels are insured

Residuary the balance remaining, as in an estate after specific bequests and debts have been paid

Respondeat Superior (let the master answer) the principal is liable in certain cases for the wrongful acts of his agent; the doctrine does not apply where the injury occurs while the servant is acting outside the legitimate scope of his or her authority

Respondentia an early form of marine insurance on cargo; similar to bottomry, the equivalent on hulls

Restoration reinstatement, as the amount of coverage after a loss

Retention the act of retaining an exposure to loss: also that part of the exposure that is retained

Retroactive Conversion conversion of term life insurance into whole life insurance at the insured's original age at issue rather than at the insured's attained age at conversion

Retrocession the amount of risk that a reinsurance company reinsures; the amount of a cession which the reinsurer passes on

Retrospective Rating the process of determining the cost of an insurance policy after expiration of the policy, based on the loss experience under the policy while it was in force

Return Premium an amount due the insured upon cancellation of a policy

Revival the reinstatement of a lapsed policy by the company upon receipt of evidence of insurability and payment of past due premiums with interest

Revocable Beneficiary a beneficiary designation that may be changed by the policy-owner without the consent of the existing beneficiary

Rider a document which amends the policy: it may increase or decrease benefits, waive a condition or coverage, or in any other way amend the original contract - the terms rider and endorsement are often used interchangeably

Risk in the abstract, used to indicate a condition of the real world in which there is a possibility of loss; also used by insurance practitioners to indicate the property insured or the peril insured against

Risk Management a scientific approach to the problem of dealing with the pure risks facing an individual or an organization in which insurance is viewed as simply one of several approaches for dealing with such risks

Risk Retention Act a 1986 federal statute that exempts risk retention groups and insurance purchasing groups from a substantial part of state regulation

Risk Retention Group group-owned insurer formed under Risk Retention Act of 1986, whose primary activity consists of assuming and spreading the liability risks of its members

Robbery the unlawful taking of property by violence or threat of violence

Salvage value recoverable after a loss: that which is recovered by an insurance company after paying a loss; see Subrogation

Schedule a list of coverages or amounts concerning things or persons insured

Schedule Rating a system of rating in which debits and credits are added and subtracted from a base rate to determine the final rate for a particular insured

Second-Injury Fund in workers' compensation, a state fund that pays the increased benefits when a second work-related injury combined with a previous injury results in greater disability than would be caused by the second injury only

Self-Insurance a risk retention programme that incorporates elements of the insurance mechanism

Senior Professional Public Adjuster (SPPA) professional designation granted to public adjusters with 10 years' experience who pass a rigorous examination and meet other specified eligibility requirements

Separate Account funds held by a life insurer that is segregated from the other assets of the insured and invested for pension plans

Settlement Option one of the ways other than immediate payment in a lump sum, in which the policyholder or beneficiary may choose to have the policy proceeds paid

Short Rate Cancellation cancellation with a less than proportionate return of premium: see Pro Rata Cancellation

Short-term Disability a generally accepted period of time for two years or less: can vary according to company standards

Sickness Insurance a form of health insurance against loss by illness or disease

Single Premium Whole Life a whole life policy in which the initial premium, together with interest earnings, is sufficient to pay the cost of the policy over its lifetime

Single Premium Deferred Annuity an annuity under which the initial premium accumulates together with investment income to create a fund that will be paid out to the annuitant at some time in the future

Social Insurance compulsory insurance, in which the benefits are prescribed by law and in which the primary emphasis is on social adequacy rather than equity

South-Eastern Underwriters Association (S.E.U.A) case U.S. Supreme Court decision in 1944 that reversed the decision in Paul v. Virginia and held that insurance is interstate commerce

Special Agent a representative of an insurance company who travels about a given territory dealing with agents and supervising the company's operations there

Special Damages amount awarded in litigation to compensate for specific identifiable economic loss

Speculative Risk a condition in which there is a possibility of loss or gain

Split Funding a technique in which a part of the contributions to a pension plan is paid to a life insurer and a part is invested separately under a pension trust

SPPA see Senior Professional Public Adjuster

Sprinkler Leakage Insurance insurance against loss from accidental leakage or discharge from a sprinkler system due to some cause other than a hostile fire or certain other specified causes

Staff Adjuster one who adjusts losses and is paid a salary by one company for all his time

Standard Provisions (health insurance) a set of policy provisions prescribed by law setting forth certain rights and obligations of both the insured and company: these were originally introduced in 1912 and have now been replaced by the Uniform Provisions

Statutory Accounting accounting prescribed by regulatory authorities for insurance companies. Under the statutory account system, GAAP (Generally Accepted Accounting Principles) are not followed, but statutory conventions replace GAAP

Statutory Profit the profit of an insurer computed under the statutory system of accounting

Stock Insurance Company an insurance company owned by stockholders, usually for the purpose of making a profit

Straight Life Insurance whole life insurance on which premiums are payable for life

Subrogation an assignment or substituting of one person for another by which the rights of one are acquired by another in collecting a debt or a claim, as an insurance company stepping into the rights of a policyholder indemnified by the company

Substandard (impaired risk) risks that have some physical impairment requiring the use of a waiver, a special policy form, or a higher premium charge

Suicide Clause life insurance policy provision that limits the insurer's liability to the return of premiums if the insured commits suicide during the first two years of the policy

Superfund a federal environmental cleanup fund created principally from taxes on the chemical industry intended for use in cleaning up waste dumps

Supplementary Contract an agreement between a life insurance company and a policyholder or beneficiary by which the company retains the proceeds payable under an insurance policy and makes payments in accordance with the settlement option chosen

Supplementary Medical Insurance (SMI) optional insurance under the Medicare programme that covers physicians' fees and other specified medical services

Surety a guarantor of a duty or obligation assumed by another

Surety Bond an agreement providing for monetary compensation should there be a failure to perform certain specified acts within a stated period: the surety company, for example, becomes responsible for fulfilment of a contract if the contractor defaults

Surplus Line commonly used to describe any insurance for which there is no available market to the original agent or broker, and which is placed in a nonadmitted insurer in accordance with the Surplus or Excess Line provisions of state insurance laws

Surrender Cost Index in life insurance, a measure of the cost of a policy, including interest forgone, if the policy is surrendered for its cash value at the end of a specified period

Tail Coverage an extended reporting period extension under claims-made liability policies that provides coverage for losses that are reported after termination of the policy

Tender Offer Defence Expense Insurance insurance designed to reimburse a publicly held corporation for defence expenses in resisting takeover attempts

Term the length of time covered by a policy or a premium

Term Insurance insurance payable to a beneficiary at the death of the insured, provided death occurs within a specified period, such as 5 or 10 years, or before a specified age

Theft the unlawful taking of property of another: the term includes such crimes as burglary, larceny, and robbery

Third Party someone other than the insured and insuring company

Third Party Insurance liability insurance, so called because it undertakes to pay to a third party sums which the insured becomes legally obligated to pay

Title Insurance insurance that indemnifies the owner of real estate in the event his clear ownership of property be upset by the discovery of faults in his title; largely written by companies specializing in this class alone

Tort an injury or wrong committed against an individual

Total Disability disability which prevents the insured from performing all the duties of his occupation or any occupation; the exact definition varies among policies

Travel Accident Policies those that are limited to paying for loss arising out of accidents occurring while travelling

Trespasser one who enters property of another without permission. A property owner generally is obligated to avoid intentional injury to trespassers

Trust transfer of property right to one person called a 'trustee' for the benefit of another called a 'beneficiary'

Trust Fund Plan a pension plan administered by a trustee rather than by an insurance company

Twisting the act of switching insurance policies from one company to another, to the detriment of the insured

Uberrimae Fidel literally, of the utmost good faith. The basis of all insurance contracts - both parties to the contract are bound to exercise good faith and do so by a full disclosure of all information material to the proposed contract

Umbrella Liability Insurance a form of excess liability insurance available to corporations and individuals protecting them against claims in excess of the limits of their primary policies or for claims not covered by their insurance programme. This later coverage requires the insured to be a self-insurer for a substantial amount (\$10,000-\$25,000)

Underinsured Motorist Coverage a form of automobile coverage that pays for bodily injury to insured persons by a motorist who has insurance that meets the requirements of the financial responsibility law, but is insufficient to cover the loss sustained by the insured

Underwriting the process by which an insurance company determines whether or not and on what basis it will accept an application for insurance

Unearned Premium that portion of the original premium for which protection has not yet been provided because the policy still has some time to run before expiration. A property and liability insurer must carry unearned premiums as a liability on its financial statement

Uniform Provisions statutory policy provisions which specify the rights and obligations of the insured and company

Uninsured Motorist Coverage a form of automobile insurance that pays for bodily injury to an insured person by a motorist who is uninsured, a hit and-run driver, or a driver whose insurer becomes insolvent

Universal Life Insurance a flexible premium life insurance policy under which the policyholder may change the death benefit from time to time (with satisfactory evidence of insurability for increases) and vary the premium payments. Premiums (less expense charges) are credited to a policy account from which mortality charges are deducted and to which interest is credited at rates which may change from time to time

Unsatisfied Judgment Fund a state fund created to reimburse persons injured in automobile accidents who cannot collect damages awarded to them because the responsible party is either insolvent or uninsured. Such funds are often financed by an addition to the regular automobile registration fee and will only pay unsatisfied judgments up to fixed limits

Usual, Customary, and Reasonable (UCR) Charges in health insurance. an approach to benefits under which the policy agrees to pay the 'usual, customary and reasonable' charges for a procedure, rather than a stipulated dollar amount

Valued Policy an insurance contract in which the value of the thing insured and the amount to be paid in case of total loss is settled at the time of making the policy

Valued Policy Law a state statute that specifies that in the event of a total loss, the insured shall receive in payment the full amount of the policy, regardless of the principle of indemnity

Vanishing Premium Policy a participating whole life policy on which dividends are allowed to accumulate until accumulated dividends plus future dividends are sufficient to pay all future premiums under the policy

Variable Annuity an annuity contract under which the amount of each periodic payment fluctuates according to the investment performance of the insurer

Variable Life Insurance life insurance under which the benefits are not fixed but relate to the value of assets behind the contract at the time the benefit is paid

Variable Universal Life a form of life insurance (also called Universal Life II) that combined the flexible premium features of universal life with the investment component of variable life

Vesting a provision that a participant in a pension plan will, after meeting certain requirements, retain the right to the benefits he or she has accrued

Vicarious Liability in law, liability arising out of imputed negligence

Void of no force or effect: null

Waiting Period (also sometimes called 'elimination period' or 'probation period') a provision designed to eliminate disability claims for the first number of days specified for each period of disability: the waiting period may run from three days to as long as one year: this term is also sometimes used to refer to a period of time after policy issuance during which specified conditions are not covered

Waiver the voluntary relinquishment of a known right

Waiver of Premium a provision which waives payment of the premium which becomes due during a period of covered total disability which has lasted for a specified period of time, usually, three to six months

Warranty a statement concerning the condition of the item to be insured which is made for the purpose of permitting the underwriter to evaluate the risk; if found to be false, it provides the basis for voidance of the policy

Whole Life Insurance insurance payable to a beneficiary at the death of the insured wherever that occurs: premiums may be payable for a specified number of years (limited-payment life) or for life (straight life)

Workers' Compensation a system of providing for the cost of medical care and weekly payments to injured employees or to dependants of those killed in industry in which absolute liability is imposed on the employer, requiring him or her to pay benefits prescribed by law

Written Premiums the premiums on all policies which a company has issued in some period of time, as opposed to 'earned premiums'

