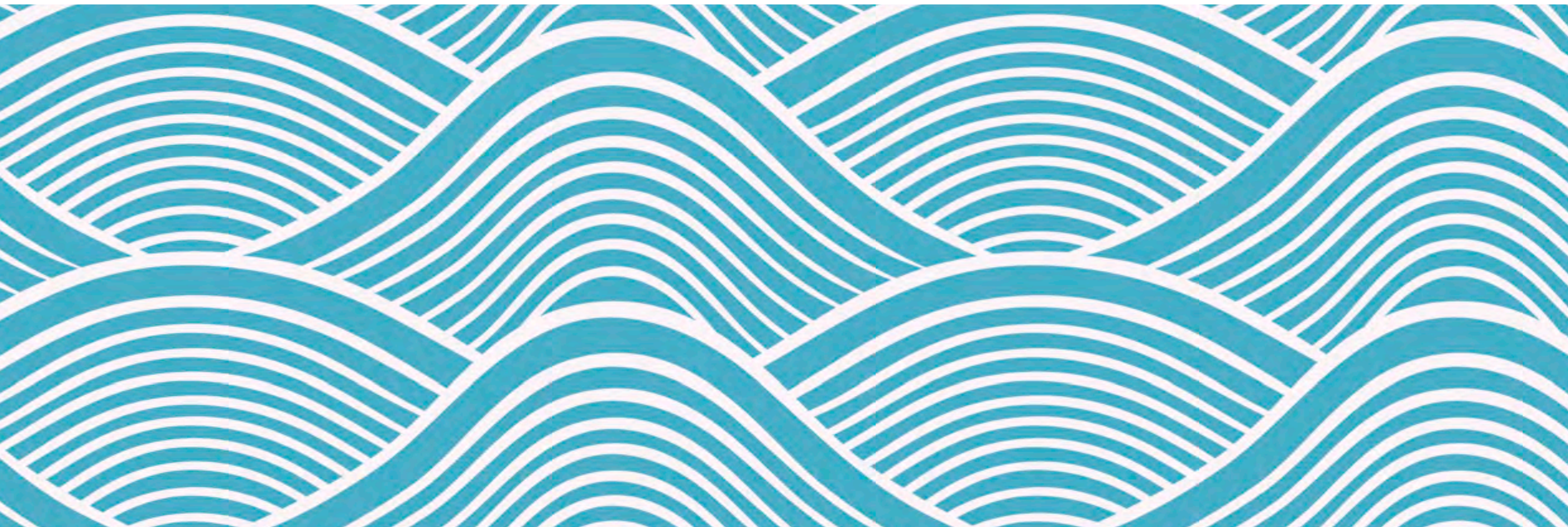
Policy Guidance on the Structure of Insurance Regulation and Supervision



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Foreword

The OECD has carried out reviews of insurance markets, with a focus on market, regulatory and market access issues, and in this process have issued many policy recommendations that relate to the structure and arrangements for insurance regulation and supervision. The insights gained through this process have given rise to general as well as broader questions on how countries should organise their insurance regulation and supervision and the rationale for different approaches.

One of the key objectives of this policy guidance is to provide a better understanding of concepts and definitions related to insurance regulation and supervision, and best practices in this area. With a better grasp of the nuances and practical application of the key concepts, insurance authorities will have an opportunity to consider how they might introduce best practices into their structures, and/or how to integrate the unique characteristics of their local market.

It is recommended that this Policy Guidance be accompanied with an understanding of the International Association of Insurance Supervisors (IAIS) Insurance Core Principles (ICPs), which are an important international standard on insurance supervision.

Table of contents

Executive summary

One of the key objectives of the policy guidance would be to develop a better understanding of concepts and definitions related to insurance regulation and supervision, and best practices in this area. With a better grasp of the nuances and practical application of the key concepts, insurance authorities will have an opportunity to consider how they might introduce best practices into their structures, and/or how to integrate the unique characteristics of their local market.

The local market will have a heavy bearing on the institutional structure. How the insurance authorities are currently structured and in relation to other financial sectors will be critically important. Whether the insurance authority is housed individually or together with other financial sectors will affect how the insurance authority is structured and budgeted, as well as how insurance specific objective may or may not be reflected in the objectives of the institution.

The types of insurance companies that are being regulated and supervised in the market will also impact the functioning of the insurance authority. The complexity and size of insurance companies will affect how an insurer is regulated, with the need for regulation and supervision to be more comprehensive and strengthened in proportion to its complexity and size. This will have a direct impact on the size of the regulator/supervisor, and subsequently the budget for insurance supervision and regulation. This also reflects the general direction of financial supervision to be risk-based and proportionate.

The differentiation between insurance regulation and insurance supervision is not straight forward, as while having distinct and different functions, there is confusion when an attempt is made to use them reflecting their more fundamental meaning or to understand structures and division of functions in a country. International Association of Insurance Supervisors (IAIS) Insurance Core Principles (ICPs) intentionally use the terms ‘supervision’ to refer to both supervision and regulation. The policy guidance will attempt to better clarify the different purposes, functions and processes involved, and clarify how different responsibilities can be allocated.

Another important aspect is how market development is included in mandates of insurance regulation and supervision. Regional integration, such as in the European Union, and bilateral/regional trade agreements, also affect the manner in which regulations and supervision are undertaken at the national level and could have an impact on structures of regulation, supervision and the institutions behind them. There could be standards set at the regional level in terms of institution or mutual recognition of regulations taking place.

There is a strong need to ensure consistency with ICPs and coordination with the IAIS. With this in mind, but recognising that the Committee represents a different group of authorities to that of the IAIS, the Committee could develop guidance that is more detailed than the ICPs for some areas, but also with a heavier focus on institutional and regulatory aspects. Cross-references have been made with relevant ICPs, which strengthens the link to the relevant ICPs, as well as reinforcing the understanding of ICPs. Principle Statements and Standards in the ICP material have been referred to in the draft policy guidance, but not the Guidance.[1]

[1] For reference (from IAIS, Insurance Core Principles and Common Framework for the Supervision of Internationally Active Insurance groups, Updated November 2019):

The policy guidance follows these main components:

- Definitions and concepts: in addition to definitions used, this section should also expand on how the size and structure of the insurance system can be taken into account, as well as what local consideration could be made.
- Framework on institutional structure of insurance regulation and supervision: this section will discuss the core framework conditions of institutions, as well as the different institutions that are involved and how they differ in the role and responsibility. Different institutional structures are also considered.
- Objectives and mandates of insurance regulators and supervisors: core objectives as well as additional objective and how they interact is considered in this section.
- Independence and accountability of institutions: this section expands on the various types of independence and what should be considered in approaching them. Accountability measures and what options there are in developing them are also considered.

Taking into consideration the specific areas the Committee wishes to address and drawing on lessons from other OECD guidance on how to best achieve this, the policy guidance integrates the following elements:

- Concepts and definitions: key concepts and definitions can be elaborated, so they can be referred to throughout the policy guidance.
- Differentiate between material consideration, and related considerations when discussing various approaches and policies.
- Include a list of items or questions that a country may wish to consider when approaching subjects that are raised in this policy guidance.
- Include country examples where it might be relevant or useful to understand approaches that are being taken.

With this in mind, a set of policy guidance has been developed using the above structure and leveraging the report of the Committee, by transforming the findings into more concrete policy guidance for each section as well as reinforcing the understanding with additional inputs (Annex A). In addition, some areas that were not necessarily elaborated in the report, but are implied, have been developed or marked for further additional information.

- Principle Statements – the highest level in the hierarchy which set out the essential elements that must be present in a jurisdiction in order to protect policyholders, promote the maintenance of fair, safe and stable insurance markets and contribute to financial stability.
- Standards – the next level in the hierarchy linked to specific Principle Statements. Standards set out key high-level requirements that are fundamental to the implementation of the Principle Statement and should be met for a jurisdiction to demonstrate observance with the particular Principle Statement.
- Guidance – the lowest level in the hierarchy supporting the Principle Statement and/or Standards. Guidance facilitates the understanding and application of the Principle Statement and/or Standards; it does not represent any requirements. The wording used in Guidance varies to reflect the intended weight of the text; for example, the use of “should” provides more of a recommendation, whereas the use of “may” is more of a suggestion. Where appropriate, Guidance provides examples of ways to implement the Principle Statements and/or Standards.

Background

The OECD's Insurance and Private Pensions Committee (IPPC) and its Working Party of Governmental Experts on Insurance have been engaged in the review of insurance systems for a number of years, primarily through the accession reviews of candidate countries that have applied to join the OECD. The reviews focus on market, regulatory and market access issues, but given the nature of the Committee, many policy recommendations to countries acceding relate to the institutional structure and arrangements for insurance regulation and supervision. The insights gained through this process have given rise to general as well as broader questions on how countries organise their insurance regulation and supervision. It has provided an opportunity for delegates of the IPPC to reflect upon current international standards and recommendations on this issue, on how countries are arranging their regulatory and supervisory structure and the rationale for different approaches.

Based on such discussions, the Committee held a roundtable on the institutional structure of insurance regulation and supervision during its December 2017 meeting, on the occasion of the 100th Insurance and Private Pensions Committee session.

To inform the Roundtable, a questionnaire was circulated to OECD and non-OECD Members, with assistance from the International Association of Insurance Supervisors (IAIS). Responses from the questionnaire were received from 28 OECD Members and 22 non-Members.[2] The number and diversity of responses have assisted in ensuring that the report examined a wide range of insurance markets in terms of both level of development and size.

As a result of the discussion at the Roundtable and subsequent discussions during the Committee meeting, the Committee published its report on the Institutional Structure of Insurance Regulation and Supervision in October 2018[3]. During this discussion, the Committee expressed a strong interest in developing some form of policy guidance to complement the IAIS Insurance Core Principles (ICPs)[4] on the objectives,

[2] OECD Member countries that contributed to the draft report are Austria, Belgium, Canada, Chile, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Israel, Italy, Japan, Korea, Latvia, Lithuania, Luxembourg, Mexico, Poland, Portugal, Spain, Sweden, Switzerland, United Kingdom and United States.

Non-OECD Members that contributed to the draft report are Albania, Argentina, Belize, Bolivia, Brazil, Colombia, Costa Rica, Egypt, Hong Kong (China), Montenegro, Nicaragua, Panama, Peru, Philippines, Romania, Russian Federation, South Africa, Sri Lanka, Suriname, Tunisia, Uruguay and Vanuatu.

[3] See www.oecd.org/finance/The-Institutional-Structure-of-Insurance-Regulation-and-Supervision.pdf.

[4] For reference (from IAIS, Insurance Core Principles, November 2018):

- ICP statements –Highest level of hierarchy and prescribe the essential elements that much be present in the supervisory regime in order to promote a financially sound insurance sector and adequate level of policyholder protection.
- Standards – linked to an ICP statement and presented in bold font, with the number of the applicable principle statement followed by the standard number. It sets out key high level requirements that are fundamental to the implementation of ICP statement and should be met to demonstrate observance with the ICP.
- Guidance material – linked to a particular ICP statement and/or standard. Guidance material provides detail on how to implement an ICP statement or standard. Guidance material does not prescribe new requirements, but describes what is meant by the ICP statement or standard and, where possible, provides examples of ways to implement the requirements.

powers and responsibilities of insurance supervisors with a broader view of the institutional arrangements for both insurance regulation and supervision. ICPs referred in the below guidance are of the public November 2019 version.

In this vein, the Committee agreed during the June 2018 Committee meeting to carry out the next phase of this work by developing policy guidance/recommendations. This would include guidance on the institutional structure of insurance regulation and supervision as well as issues related to the independence and accountability and mandates and objectives of insurance regulators and supervisors.

About the Policy Guidance on the Structure of Insurance Regulation and Supervision

The OECD's Insurance and Private Pensions Committee embarked on a project to examine how countries' have set up their structure for insurance regulation and supervision in 2017. Based on an extensive discussion on the topic in December 2017 and a report in 2018 (http://www.oecd.org/finance/The-Institutional-Structure-of-Insurance-Regulation-and-Supervision.pdf), the Committee has developed policy guidance on the institutional structure of the insurance regulation and supervision to clarify and deepen the understanding on the topic.

This policy guidance has been developed to provide basic concepts of why certain approaches are taken and be a reference point for those seeking to understand approaches being promoted. By putting forward country practices to present practical example of implementation to assist alternative approaches.

Differences in market size and specialisation, legal traditions and government set up, as well as other factors will influence how countries execute insurance regulation and supervision, so this guidance is designed to capture most structures, but flexible and specific enough to be beneficial for any country wishing to consider these issues.

In particular, the policy guidance will be of assistance when an OECD or non-OECD country is considering reviewing their institutional structure for insurance regulation and supervision.

Countries are encouraged to notify the Committee where new input could be made with country examples.

The policy guidance includes references to the IAIS' Insurance Core Principles (ICPs) to enable authorities to complement and support the ICPs.

Policy Guidance on the Structure of Insurance Regulation and Supervision

Notation for reading the policy guidance

- **M**: material consideration (essential considerations which would have a material impact)
- **R**: related considerations (relevant but non-material considerations)
- **Q**: questions that could be discussed when considering reforms.
- **Right hand boxes**: country approaches
- **Left hand boxes**: Relevant ICPs or other international standards

1. Definitions and key concepts

1.1. Definitions

- **Regulation**: regulation is an imposition of rules by government, be it by the legislative or executive branch that are intended to specifically to modify the economic behaviour of individuals and firms in the private sector and are often enforced by the use of penalties.
- **Insurance regulation:** is the imposition of rules by government, be it by the legislative or executive branch, or another agency, that apply to insurance activities. Insurance regulation can be classified into policy-oriented regulation and non-legislative regulation.
- **Policy-oriented regulation:** legislation, usually imposed by the legislative or executive branch of the government. It typically reflects the policy direction/priorities of the government for the insurance sector. Policy-oriented regulation is binding. While the decision to adopt legislation may be made by the legislative or executive branch of the government, both policy-oriented and non-legislative regulators (which is likely to also be the supervisor) are usually involved in the process.
- **Non-legislative regulation**: is when an insurance regulator issues non-legislative regulation that supports legislation. This could be binding or non-binding. It could be issued by the policy-oriented regulator (executive branch) or non-legislative regulator, depending on the instrument, although compliance with regulations issued by the policy-oriented regulator is often compulsory.
- **Insurance supervision:** is when the insurance supervisor monitors (re)insurer and intermediary behaviour, and implements insurance rules (including legislation and regulation) through on-site and off-site supervision of (re)insurers that operate in its market to verify compliance with the requirements for engaging in financial activities and by issuing administrative measures and enforcement actions based on relevant legislation and non-legislative regulation.

- **Insurance regulator**: is any authority that initiates and develops legislation and/or non-legislative regulation (*i.e*. rule making) to address the objectives of insurance regulation, in consultation with the supervisor and other stakeholders. An insurance supervisor may also be an insurance regulator.
- **Insurance supervisor**: is any authority that carries out insurance supervision, which include licensing, monitoring, issuing administrative and enforcement action to ensure compliance with legislation and non-legislative regulation relevant to the insurance sector.
- **Insurance authority**: encompasses both the insurance regulator and insurance supervisor.
- **Independence:** being free from capture from certain stakeholders that might negatively influence outcomes, and can take regulatory and supervisory action free of conflicts of interest, without being subject to undue or inappropriate influence from stakeholders.
- **Accountability:** arises when there is delegation of power without an elected official responsible for the activities and decisions, to avoid decisions and priorities that are advantageous for its institution and ensure that they are for the benefit of the wider public utility.
- **Prudential regulation:** rules and regulation to contribute to the safety and soundness of insurance entities and contribute to the stability of the insurance market, with a view to protect policyholders.
- **Prudential supervision:** is the oversight of individual supervised entities' observance of prudential requirements, including capital and technical provisions, to contribute to their financial safety and soundness, thus being primarily a supervisory activity.
- **Market conduct regulation and supervision:** is the elements of financial regulation and supervision to protect consumers, focusing on financial institutions' behaviour.
- **Resolution:** Actions taken by a resolution authority towards an insurer that is no longer viable, or is likely to be no longer viable, and has no reasonable prospect of returning to viability.
- **Resolution authority**: A person that is authorised by law to exercise resolution powers over insurers.
- **Legislative initiative:** In most countries, a ministry (executive branch of the government) has the authority for legislative initiative, albeit with input from or draft bills being proposed by the non-legislative regulator. In some countries, the legislative arm has a strong role in proposing legislation.

1.2. Key concepts

1.2.1. Considerations in approaching the institutional structure of insurance regulation and supervision

M 1. Institutional structures should be set up to ensure the protection of the interests of policyholders, the stability and robustness of the insurance market, and to avoid inappropriate behaviour by (re)insurers and affiliated service providers. In addition, insurance regulation and supervision should contribute to the wider financial stability.

M 2. There should be a prioritisation in insurance regulation and supervision which is agreed by the relevant insurance authorities, so that all authorities are in agreement with regards to priorities and importance of issues relevant to the insurance market and can take concerted action when necessary. This should also be a relevant consideration for risk-based supervision.

Q

- What are the priorities for insurance regulation and supervision?
- How are these being decided and are there legislative or agreements that are basis for them?
- What process should be used to coordinate and agree on priorities?

1.2.2. Proportionality of regulation and supervision

M 3. The size and structure of the insurance system should be taken into account when deciding on the institutional structure, as well as insurance law, regulation and supervision.

R 4. When insurance entities have a global presence, there will be a need for stronger regulation and supervision that includes cooperation and information exchange between home and host supervisors for cross-border transactions, while maintaining the requirements of confidentiality. Insurance authorities may decide to differentiate the treatment of insurance entities based on a number of variables.

Q

- What factors and conditions are relevant to determining how to approach insurance regulation and supervision?
- What contributes to the size and complexity of the insurance market? Premium levels, claims payment levels, structural complexity, group size, market size, global reach?
- What is the scale of cross-border transactions being carried out by insurance entities?
- How should globally or locally important insurance companies be determined and then treated?

R 5. Smaller or less developed insurance markets may wish to approach prudential regulations to balance development opportunities, but ensuring progressive prudential regulations should remain the main objective. Even in this case, having sufficient market conduct rules would be important.

Proportionality and risk-based supervision (from IAIS, ICPs and CommFrame, November 2019):

"9. The ICPs establish the minimum requirements for effective insurance supervision and are expected to be implemented and applied in a proportionate manner... Supervisors have the flexibility to tailor their implementation of supervisory requirements and their application of insurance supervision to achieve the outcomes stipulated in the Principle Statements and Standards.

- Implementation - proportionality allows the ICPs to be translated in to a jurisdiction's supervisory framework in a manner appropriate to its legal structure, market conditions and consumers.
- Application - proportionality allows the supervisor to increase or decrease the intensity of supervision according to the risks inherent to insurers, and the risks posed by insurers to policyholders, the insurance sector or the financial system as a whole. A proportionate application involves using a variety of supervisory techniques and practices which are tailored to the insurer to achieve the outcomes of the ICPs. Such techniques and practices should not go beyond what is necessary in order to achieve their purpose."

Q
- What are the steps envisaged to transition towards a more developed prudential regulatory regime?

R 6. Some countries have state-owned (public) (re)insurance companies that may have a large market share. If the state-owned (re)insurance company is established as a commercial entity and active in the same markets and segments as privately-owned/commercial (re)insurance companies, it is important to ensure that regulation and supervision is applied consistently for all entities, whether publicly- or privately-owned and takes into account risk-based considerations.

R 7. In some cases, countries may have a separate regulatory regime for smaller insurance entities. In this case, there are often less burdensome prudential regulations applied to the smaller entities.

In the EU, the Solvency 2 directive authorises Member States not to apply the Solvency 2 prudential requirements to insurers fulfilling various conditions (premium income lower than €5m, technical liabilities lower than €25m, insurer does not cover certain lines of business such as 3rd party liability, credit, suretyship, funeral etc. insurance) (art.4 sq. EU S2 Directive). Consistent with these provisions, many EU countries provide a “simplified” regime for “smaller” insurers.

For example, in Austria, „kleine Versicherungsunternehmen“ (small insurance undertakings) and „kleine Versicherungsvereine“ (small mutual associations) (among other criteria their direct gross amount of annual premiums written and earned does not exceed EUR 5 million and their total technical provisions do not exceed EUR 25 million) are not covered by the Solvency II directive and are therefore subject to facilitated requirements concerning own funds, investments, governance and accounting.

R 8. Risk-based supervision may be a part of this consideration, giving priority to nature, scale and complexity of an insurance entities, in particular when they may have a stronger systemic impact to the insurance market.

1.2.3. Local and regional considerations

M 9. Given the path dependency of structures, the existing institutional structure should be the basis in which insurance regulation and supervision are organised and are considered. In particular, whether an insurance regulation or supervision is carried out in an institution responsible for other financial sectors or in the central bank will influence how insurance regulation or supervision is structured.

Q
- What are the strengths and weaknesses of the existing institutional structure?
- What needs to be improved in reviewing the existing institutional structure?

M 10. The level of development of the insurance market and the size of the market will affect what the appropriate structure should be.

Q
- What is the size and expertise available in the market for the insurance authorities to tap?
- Is the market sufficiently diverse and market share not concentrated?
- What are the areas of conflict of interests which should be taken into account?

M 11. Membership to regional integration agreements and bilateral/regional trade agreements will impact insurance regulation and supervision and how to reflect such agreements in insurance regulation and supervision.

R 12. This policy guidance should be considered when (re)structuring or reforming the institutional structure of insurance regulation and supervision.

2. The structure of insurance regulation and supervision

2.1. Framework conditions for institutional structure

M 13. Insurance authorities should be set up to ensure that insurance authorities have the appropriate credibility, integrity and legitimacy to carry out insurance regulation and/or insurance supervision.

R 14. The rationales for economic regulation are to curb potential market power and increase efficiency, or avoid duplication of facilities in cases of natural monopoly. Another objective is to protect consumers and maintain quality and other standards. These overarching objectives should be borne in mind when considering the appropriate institution for insurance regulation and supervision.

R 15. Insurance regulation and supervision are not necessarily carried out by the same institution, and further, insurance regulation can take a number of forms. These distinctions should be recognised and taken into consideration when approaching the appropriate institutional framework.

M 16. Insurance supervision should be empowered with powers, such as application of administrative sanctions, revoking licenses and authorisations, and/or issuing orders to change management of licensed or registered entities.

M 17. Given that many countries have multiple institutions involved in insurance regulation and supervision, identifying the effective and appropriate coordination mechanism is essential. This should be a formal process that involves relevant stakeholders, as well as being periodic held and timely when responding to changing market needs. This is also important to ensure that systemic and financial stability concerns are being addressed across financial sectors, and the treatment of similar products in different financial sectors can be discussed appropriately. Supervisory coordination is also necessary for financial conglomerates.

Q

- Which are the institutions that need to be involved in coordinating regulation and supervision of the insurance market?
- Which are the institutions which need to be informed of insurance market developments?
- What role and responsibility should the coordination mechanism have to be timely and effective?

R 18. If a single regulator/supervisor is responsible for the regulation and supervision of the financial sector, then there may not be a strong need for having a coordination mechanism, unless there are other institutions that need to be consulted.

R 19. Some coordination mechanisms are based on cooperation agreements or MoUs between the relevant insurance (financial) regulators and supervisors.

R 20. Many countries have a joint body comprising the relevant financial regulators, central bank and ministry involved to coordinate input and actions.

R 21. Another method through which some aspects of coordination can be achieved is by having the head of each regulator/supervisor sit on the board of the other relevant financial regulatory/supervisor.

22. In the United States, there are two joint bodies, the Federal Financial Institutions Examination Council which is a formal interagency body empowered to prescribe uniform principles, standards, and report forms for the federal examination of financial institutions, and the Financial Stability Oversight Council (FSOC) established by the Dodd-Frank Act of 2010 is comprised of federal financial regulatory agencies and also includes a non-voting member representing state insurance commissioners.
23. US state insurance regulators routinely coordinate country-wide regulation through the NAIC and its committees. State insurance laws generally provide for the commissioner to share confidential information with, for example, governmental entities including other state, federal and international regulators and state, federal and international law enforcement authorities.
24. For insurance regulation (or more generally, for financial regulation), some countries have established units that develop all financial regulation (Brazil, Colombia, Costa Rica). This unit generally has participation from the various public authorities at their board level.
25. In France, a joint unit is established between the insurance and banking supervisor (ACPR) and the financial markets supervisor (AMF) regarding market conduct supervision in order to display a holistic vision of the supervision and to strengthen the coordination of the financial supervisory activities ("pôle commun ACPR-AMF")".
26. Switzerland forms working groups with participation from the relevant financial regulators and supervisors to prepare legislation.

2.2. Legislation, policy-oriented regulation and non-legislative regulation

M 27. **Legislation**, which is a significant part of the regulatory framework, is decided by elected officials. While not beholden to politics, in a democratic system, interaction between the legislature and the autonomous institutions is a required and important step to ensure that the legislature understands the context of the legislation and unintended consequences can be raised/addressed early in the process.

M 28. There is an important distinction of insurance regulation between **policy-oriented regulation** and **non-legislative regulation**. Both policy-oriented and non-legislative insurance regulation should be developed in consultation with relevant stakeholders, with an appropriate consultation period for commenting.

M 29. Legislation and policy-oriented regulation of the insurance sector is developed and issued by the legislative and executive branch of the government respectively. Political independence is not generally sought for policy-oriented regulation, and input from other non-executive branch institutions (non-legislative regulators) will be routinely sought.

R 30. Non-legislative regulation consists of (formal) regulation and guidance.

- Formal regulation: may be passed by the executive branch/policy-oriented regulator (in the form of, for example, a ministerial directive) or the supervisor. It is a formal requirement towards insurance activities and binding, and is subjective to enforcement action.
- Guidance: is developed and issued by the supervisor, to provide input into how legislation and formal regulation could be interpreted. However, it is not a formal requirement, although there is often an implicit expectation of compliance.

31. In Switzerland, non-legislative insurance regulation is issued by the non-legislative regulator only and takes the form of guidance. However, any regulation issued by the executive branch would by policy-oriented regulation by the definition above.

Q
- What are the respective roles in terms of policy-oriented regulation and non-legislative regulation?
- Is there clear recognition of what each of these roles means?

2.2.1. Authority for legislative initiative

R 32. A relevant factor for EU countries (or other regional integration arrangements) is that in many cases, while the actual legislative initiative is made by a domestic institution, the substance of the legislation may be a result of a directive.

Q
- Other than the authority that has legislative initiative, are there other bodies that would practically be providing input into the legislative initiative?

2.2.2. Non-legislative regulatory instruments

M 33. Non-legislative regulation is developed based on delegated authority from legislation to elaborate specific articles of legislation.

M 34. (Formal) **regulation** is usually accompanied by an obligation to comply with the requirements and could be issued by the non-legislative regulator.

M 35. **Guidance** and other instruments are issued by supervisors to inform supervised entities of indicative direction and/or interpretation of legislation or formal regulation as well as expected related actions. Guidance is usually not binding, but there is an expectation of compliance.

Q
- Who can issue non-legislative regulation and what legal effect do they have?
- What other non-legislative regulatory instruments are necessary, and what function do they have vis-à-vis regulation?

2.3. Institutional structure

M 36. The institutional structure of insurance regulation and supervision is important because of the impact it has on the efficiency and effectiveness of regulation, directly and indirectly affecting the cost and success of regulation in meeting its statutory objectives. Their structure also affects how the authorities are perceived, which impacts their reputation and credibility

Q
- What institutional structure enables regulators and supervisors to effectively achieve their objectives and mandates in a manner that maintains their reputation and credibility, as well as instilling confidence from the insurance market?

M 37. To be an effective and efficient insurance regulator and supervisor, one of the most important implicit requirement is to have legitimacy and credibility, which leads to confidence in the activities and decisions that they make. Such legitimacy and credibility would promote confidence in the insurance system and its institutions. This is why establishing a structure with clear objectives and functions of insurance regulation and supervision, and has a structure to enable timely decision making when necessary as well as the delivery of those decisions, which should be in proportion to the weakness of the insurer/system, is critical. The insurance regulator and supervisor should have integrity and transparency in their actions as a prerequisite.

Q
- Is there credibility and legitimacy of existing insurance authorities? If not, what has led to the loss of credibility and legitimacy?

38. According to the Financial Sector Assessment Program (FSAP) Handbook, the legal and institutional framework for financial supervision should cover:

- the identity of the supervisor (central bank or separate agency), terms of reference, powers, and authority of the supervisory agency;
- the authority and processes for the issuance of regulations and guidance;
- the authority and tools to monitor and verify compliance with the regulations and principles of safe and sound operations;
- the authority and actions to remedy, enforce, take control, and restructure; and
- the procedures to delicense and liquidate problem institutions that cannot be restructured.

R 39. There are two approaches to establishing institutions to carry out financial regulation and supervision:

- delegation of authority to a government agency, a specific minister, local authority or other official body; or
- Granting statutory powers to an institution, which is not a government agency.

40. While institutional and political independence may not be assured for the former, operational independence could be present.

41. In FSAPs, the lack of independence from the ministries of finance has been a major issue—mainly in developing countries, by having the ministries of finances carry out insurance supervision. This indicates that, in terms of FSAPs, the expectation is to have an independent agency, particularly for supervision, that are not delegated authority to a government agency.
ICP 2.1: The supervisor is operationally independent and free from undue government or industry interference that compromises that independence.

R 42. A number of countries have established an integrated supervisor by merging the supervision of all financial sectors, including insurance, banking and securities sectors, in one entity.

R 43. Some countries have different institutions for prudential and market conduct regulation and supervision, leading to a separation even within the insurance supervisor.

R 44. A specialist financial supervisor often develops regulation with a responsible ministry, primarily the ministry of finance.

R 45. Many institutions responsible for insurance supervision will also oversee other financial sectors (*i.e.*, banking, pensions or securities sectors).

46. The central bank is responsible for both insurance supervision in Belgium (conduct supervision by the Financial Services and Market Authority), Lithuania, Suriname, United Kingdom (prudential supervision by the Prudential Regulation Authority, part of the Bank of England, and conduct supervision by the Financial Conduct Authority), Uruguay and Vanuatu. The central bank is responsible for insurance supervision in Czech Republic, Greece, Hungary, Russia.
47. In Brazil and Peru, apart from the general insurance supervisor, health insurance is supervised by another entity (although in Peru, prudential regulation of health insurance is carried out by the financial supervisor/regulator, SBS). In Germany, the Federal Insurance Office regulates statutory health insurance funds

M 48. To ensure a good institutional set up and so that accountability can be addressed, the institutional structure of an insurance supervisor should include:

- clear legal basis of its powers and functions, preferably set out in statute;
- clear objectives that describe its basic purposes;
- the relationship of the agency with the executive branch is clearly defined;
- officials of the agency must have security of tenure and laws that stipulate who can appoint and dismiss senior official and under what conditions (which should be limited to situations such as acting in bad faith or gross negligence);
- while rules-based procedures for institutional structures are preferable to discretionary ones, there should be scope for the independence of the agency to be overridden (e.g., in a crisis situation) but triggers may have to be defined;
- the procedures by which the agency can be held accountable to the parliament from which it has been delegated authority needs to be defined;

- the agency should be subject to judicial review with respect to the manner in which it exercises its power, with a mechanism and process that is specified;
- an open decision-making procedure for transparency purpose;
- an agency should be held accountable for its finances.

Q
- Have all the items in the list above been addressed or taken into account when considering the institutional set up for insurance regulation and supervision?

R 49. How the institutions for financial supervision are structured should reflect the priorities and issues of the financial sectors. Decision making for any of the financial sectors should be made in a timely manner, and coordination able to take place readily. If supervisory action cannot be appropriately executed or monitoring sufficiently carried out, the strengths and weaknesses of the institutional structure should be carefully reviewed.

R 50. To better ensure impartiality and objectivity, some supervisors may choose to clearly separate different functions within their institutional structure

51. In France for instance, the insurance supervisor has 3 different boards: the supervisory board, which oversees "normal" supervision; the "sanction board", which, on request from the supervisory board, can impose sanctions to supervised entities; and the resolution board, which, on request from the supervisory board, can decide to put an insurer into resolution when this latter is considered inviable. It is expected, in particular, that having a board which decides on sanctions, that is different from the board which deems those sanctions necessary and requests them, ensures better impartiality and objectivity.

2.4. Risk-based supervision

M 52. The effectiveness and efficiency of supervision is being addressed primarily through risk-based supervision, which requires supervisors to assess system and individual firm risk and to respond with the supervisor's own process and interventions in line with the assessment. This allows supervisors to allocate resources to insurers with the greatest risk and/or risk areas with individual insurers that are of high risk.

R 53. Most countries have an annual assessment, either based on regulatory reporting or monitoring results, to determine their priorities for risk-based supervision. While there is consensus that the nature, scale, profile and complexity of insurers is the basis for determining priorities for risk-based supervision, domestic priorities and issues and other variables are also taken into account. Impact and risks of insurers could also be a consideration for risk-based supervision.

Q
- What are the main characteristics, entities and risk areas which are important for the insurance market?
- How should resources be allocated to balance the importance of certain institutions or risk areas, which ensuring that a broad view of the market can be maintained?

54. Hungary, Italy and Lithuania use supervisory processes to undertake a risk assessment which determines the intensity of supervision of a financial institution, as well as the need for further examination or focus.
55. Mexico has a risk-based supervisory structure that builds on the three pillars of quantitative, revision and control, and market discipline.
56. Japan sets its priorities annually, which are then communicated publicly. Current priorities include sustainability of insurers' business models and governance of large insurers.
57. Switzerland targets greater supervisory resources to large insurers and insurance groups.
58. South Africa has a proposed Solvency Assessment and Management (SAM) supervisory approach, which is forward looking, risk-based and proactive, recognising that the board and management of insurers and groups are primarily responsible for financial soundness and prudent risk management
59. MAS assesses both the impact and risks of insurers, and distinguishes those insurers that may pose a higher threat to the achievement of our supervisory objectives. This determines the appropriate supervisory strategies and the level of supervisory intensity required for each insurer.

2.5. Prudential and market conduct regulation and supervision

R 60. It is generally accepted that insurance regulation and supervision should encompass both prudential and market conduct considerations.

R 61. However, there is no consensus on whether this should be carried out in separate divisions of one institution, or in separate institutions. More important is that there is recognition of the two aspects of regulation and supervision, and sufficient resources are allocated in recognition of this.

ICP 1.2 requires that primary legislation clearly determines the objectives of insurance supervision that include at least to protect policy holders, to promote the maintenance of a fair, safe and stable insurance market, and to contribute to financial stability (see Section 3). Consistent with this, ICPs 18 and 19 (among others) are centered on market conduct issues.

62. In France, legislation explicitly provides that supervision ensures that insurers "are in capacity of keeping their commitments to policyholders, and effectively keep them"; and at the end of 1990s, this legislation allowed the supervisor to make sanctions against insurers which were overly slow in settling claims.

63. Some countries have opted to have separate institutions for prudential and market conduct regulation and supervision. This enables both aspects to be given the necessary attention, with a clearer mandate and role for each institution. This can, however, create coordination issues, as well as uncertainty for issues that do not neatly fit into either institutions to be missed or there is an overlap of responsibilities between institutions creating uncertainty with regard to the lead agency. Administrative functions, such as legal, IT, HR and general administration, will have to be established for both institutions, likely resulting in a more costly set up.

64. The benefit of having a single institution responsible for both prudential and market conduct regulation and supervision is that there is less need for coordination, and information exchange can be more readily assured. On the other hand and depending on how they are situated within the institution, whether as functions of the institution or with dedicated sections for each, there is a risk that both or neither will be sufficiently addressed or prioritised in a single institution if priorities are not well defined. Practically speaking, common functions, such as legal, IT, HR and general administration, do not need to be duplicated in two institutions.

65. A number of countries effectively have a twin peak approach, with separate institutions carrying out the prudential supervision and market conduct regulation. In Belgium, the National Bank of Belgium is responsible for prudential supervision, while the Financial Services and Markets Authority is responsible for market conduct. In Canada, the Office of Superintendent of Financial Institutions (OSFI) is responsible for prudential supervision of federally incorporated/registered insurers, while the Financial Consumer Agency of Canada and provincial insurance regulators are responsible for market conduct.
66. In Iceland and Poland, while the financial supervisors, Financial Supervisory Authority (FME) and Financial Supervision Authority (KNF), are respectively responsible for both prudential supervision and market conduct, they share market conduct responsibility with the Competition Authority, as it pertains to federal institutions, and the Office of Competition and Consumer Protection respectively.
67. In the United Kingdom, the Prudential Regulation Authority (PRA)(part of the Bank of England) is responsible for the prudential oversight for both regulation and supervision, while the Financial Conduct Authority (FCA) is responsible for market conduct and consumer protection and covering both regulation and supervision of those areas.
68. South Africa enacted the Financial Sector Regulation Act (FSR Act) which, amongst other things, establishes two regulators/authorities, namely the Prudential Authority (PA) within the South African Reserve Bank (SARB) and a new conduct authority, the Financial Sector Conduct Authority (FSCA) (the former Financial Services Board). The PA will supervise the safety and financial soundness of banks, insurance companies and other financial institutions while the FSCA will supervise how financial services firms conduct their business and treat customers
69. Australia adopted a twin peak model establishing the Australian Prudential Regulation Authority (APRA), being the responsible for the prudential supervision of banking, insurers and superannuation funds, and the Australian Securities and Investments Commission (ASIC) being responsible for promoting market integrity and consumer protection across the financial services and payment systems

3. Objectives and mandates of insurance regulation and supervision

M 70. For an insurance regulator and supervisor to operate effectively and be accountable for its actions, having clear mandates and objectives in the statutes establishing the institution is critical. Having clear objectives also contributes to an institution being able to achieve integrity in its day-to-day operations.

M 71. Core objectives of insurance regulation and supervision are:

- protect consumers and policyholders of insurance, in particular from the insolvency of insurers;
- oversee the and stability of the insurance sector, and
- ensure a level playing field in the insurance market.

ICP 1 Objectives, Powers and Responsibilities of the Supervisor

Each authority responsible for insurance supervision, its powers and the objectives of insurance supervision are clearly defined.

ICP 1.1 Primary legislation clearly defines the authority (or authorities) responsible for insurance supervision.

ICP 1.2 Primary legislation clearly determines the objectives of insurance supervision and these include at least to:

- protect policyholders;
- promote the maintenance of a fair, safe and stable insurance market; and
- contribute to financial stability.

Q

- Are there clear objective and mandates of insurance regulation and supervision identified in the main insurance legislation?
- Do they cover the main objectives of safety and stability of the insurance market?
- Are the functions, roles and authority of the insurance regulator and supervisor clearly recognised in the legislation?

M 72. Any insurance regulator and supervisor should keep, as a key objective, the safeguarding of the interests of the insured and beneficiaries, bearing in mind that:

- Some countries may opt to include additional objectives, which may then necessitate primary and secondary objectives to be clarified.
- When the insurance regulator/supervisor is part of an institution which regulates and supervises other financial sectors, identifying how the objectives of that institution relates to the insurance sector is important.
- Coordinating insurance regulation and supervision with other financial sector authorities is important, whether as part of the same institution or inter-agency coordination, to ensure that standards and supervision within the financial system are appropriate and maintain a level playing field. The coordination mechanism should be explicitly identified in legislation, to ensure that all parties have the mandate to exchange information and coordinate actions.

R 73. Regulators and supervisors may perform better in a single-objective or a primary objective identified institution, due to potential conflicting actions between officials being mitigated.

R 74. Guidance should be provided in case there is a conflict of different objectives that the insurance regulator and supervisor should follow. Such guidance should either provide an order of priority of the objectives, or reconcile any conflicts with the discretion of the supervisor.

Q

- Is there a need to have additional objectives of insurance regulation and supervision?
- If so, has any prioritisation of the objectives been made and clarified in the legislation?

R 75. Additional objectives may include:

- development of the insurance market
- financial inclusion
- promoting competition of financial markets
- contributing to the development of the national economy and promoting reputation and professional standards in the insurance industry
- allowing or promoting technology and innovation in the market.

R 76. It should be ensured that the reputation of insurance regulators and supervisors can be maintained by executing objectives in an equitable and reasonable manner.

4. Independence and accountability of institutions

M 77. It is important that independence and accountability of the insurance authorities are employed side-by-side and in a multi-dimensional manner ensuring that their many facets are considered.

4.1. Independence

M 78. As insurance (financial) supervisors deal with economically powerful entities, *i.e.*, insurance (financial) institutions, ensuring freedom from regulatory capture from the industry is particularly essential for financial supervision.[5] The shorter time horizon of politicians, which are centred around election cycles, and their political interests necessitates that insurance (financial) supervisors are also insulated from political interference and considerations when taking supervisory action.

[5] More details on regulatory and supervisory independence can be found in: OECD (2018), *The Institutional Structure of Insurance Regulation and Supervision*, www.oecd.org/finance/The-Institutional-Structure-of-Insurance-Regulation-andSupervision.pdf.

R 79. Regulatory capture occurs when industry interests are identified as public interests, as bureaucracies can respond to the wishes of the best organised interest groups rather than to political directives or public interest.

M 80. Independence of insurance authorities should bear in mind the following principles:

- A policy-oriented regulator cannot be independent from political processes, especially as it is often part of the legislative process. However, a policy-oriented regulator should be free of regulatory capture.
- A non-legislative regulator should be clear of both political interference and regulatory capture especially in the formulation of non-legislative regulation.
- An insurance supervisor should have political, regulatory, supervisory, institutional, budgetary and operational independence.

Q
- Have there been instances where political interference or regulatory capture may have influenced regulatory or supervisory outcomes?

4.1.1. Independence of an insurance supervisor

M 81. Independent insurance supervisors have powers, such as the possibility of withdrawing a license and limiting activities of insurance entities, which could have a more powerful and direct effect on those entities. To prevent the abuse of power and ensure that insurance supervision is carried out by highly qualified and supervisors, it is essential to have independent well-paid supervisors who are subject to full accountability arrangements.

R 82. Independence of an insurance supervisor has four main elements: political independence, regulatory independence, institutional independence, and supervisory independence.

> ICP 2 Supervisor
>
> The supervisor is operationally independent, accountable and transparent in the exercise of its responsibilities and powers, and has adequate resources to discharge its responsibilities..

M 83. **Political independence**: an insurance supervisor should be free of political interference to support supervisors taking decisions against economically powerful entities and political interests.

> ICP 2.1 The supervisor is operationally independent and free from undue government or industry interference that compromises that independence.

M 84. **Regulatory independence:** an insurance supervisor should be independent in the development and issuing of non-legislative regulation within the scope provided by legislation and policy-oriented regulation, so that guidance towards the insurance sector can be developed and issued independent from industry or narrow political interests.

Q
- Does the non-legislative regulator have the authority and independence to develop necessary and appropriate non-legislative regulation, based on legislative authority, although consultation with stakeholder should also take place?

M 85. The process of adopting non-legislative regulatory instruments should involve public consultation and information of with stakeholders, specifically other parts of the government and the industry, especially for regulation where compliance is expected. This consultation process is an important step to ensure integrity and legitimacy of regulations, as well as transparency of process.

M 86. The differences between non-legislative regulatory instruments should be clarified, including the specific nature/function of each instrument, including (formal) **regulation** (mandatory), **guidance** (non-mandatory), **directive**, **circular** etc.

R 87. Other instruments (non-mandatory) that are used by non-legislative regulators include:

- **Circulars/communications** are used primarily for communication purposes.
- **Models, handbooks and manuals** are used by supervisors to guide financial institutions in their preparation of reporting or compliance with regulation, by ways of a manual which guides entities prepare their submission or when certain actions are taken.
- **Interpretation of legislation/regulation** is widely used and provides an interpretation of when a certain action might be considered to be in violation of law or regulation.
- A **no-action letter** has a similar effect to an interpretation of legislation, which is a response to financial institution's request on whether a certain product, service or action might constitute a violation of law or regulation.

4.1.2. Institutional independence

M 88. Institutional independence is when the status of the agency is separate from the executive and legislative branches of the government. Further institutional independence is achieved when there is statutory delegation of supervisory powers to a non-government agency and when subsequent government intervention or interference is avoided.

R 89. Independent institutions should have operational independence, with processes in place to enable independent decision making and day-to-day operations being free of governmental intervention. Having budgetary independence strengthens an institution's operational independence.

R 90. In some cases, insurance supervisors are established through delegated authority as part of the government. In this case, efforts should be made to ensure as much operational independence as possible with a view to transitioning to an independent institution.

> ICP 2.1: The supervisor is operationally independent and free from undue government or industry interference that compromises that independence.

Budgetary independence

M 91. An insurance supervisor should have the autonomy to set and use its budget, in consultation and in accordance with the resource needs and priorities identified based on risk-based supervision.

R 92. Budgetary independence of an insurance supervisor is relevant to ensure that the supervisor can hire highly qualified staff. This would likely be in competition with the insurance market, and having some discretion in remuneration terms and conditions assists the process of hiring staff.

R 93. The source of the budget could be diverse, whether coming from fees collected from the insurance industry, a budgetary allocation from the fiscal budget or a combination of resources, but should ensure that appropriate resources can be secured on time and balanced in a way that does not harm the operational independence of the insurance supervisor.

Q

- What is the source for financing the insurance supervisor?
- Is this source a stable and predictable source of financing, which can maintain the independence of the supervisor?
- How can supervisors ensure that they have an appropriate budget to cover their activities, while being accountable to the source of financing?

ICP 2.10 The supervisor has sufficient resources, including human, technological and financial resources, to enable it to conduct effective supervision.

M 94. There has been a general trend for insurance supervisors to be funded by assessment fees which are paid by the industry. Most countries that have an independent supervisor collect fees from supervised entities.

R 95. The way the assessment is done varies by country, with some set in regulation and some assessments done in consultation with the relevant ministry. Some supervisors consult the industry, but this also varies by country. The variation in the funding method is affected by how the supervisor is set up, including which financial sector is supervised, whether it is a single supervisor, and whether and how the central bank is involved.

Q

- What assessment method can be applied to ensure an equitable and transparent setting of assessment fees?
- How often should the assessment take place, and how often should the assessment methodology be reviewed?
- What should the role of the industry be in determining the assessment fees? Should they be able to provide input, or should they be able to contest the fee levels?
- How should the supervisor be accountable to the industry in terms of the level of budget necessary, as well as the level of expenditure made, without compromising confidential matters being discussed by the supervisors?

In Germany, BaFin raises funds required to cover its costs from the undertakings it supervises.[6] BaFin's sources of funding consist primarily of fees (for performing official acts), separate reimbursements (expensive activity carried out for an individual undertaking); and contributions (an advance payment that is payable for all other costs that are based on an assessment formula). The actual amount of fees and contributions is calculated on the basis of the Ordinance on the Imposition of Fees and Allocation of Costs Pursuant to the FinDAG (*Verordnung über die Erhebung von Gebühren und die Umlegung von Kosten nach dem Finanzdienstleistungsaufsichtsgesetz – FinDAGKostV*) and in accordance with special rules governing the charges to be applied by BaFin. Supervised entities may also be called upon to incur the costs, for example, arising as a result of the execution of enforcement measures, especially coercive penalty payments, and the imposition of fines where administrative offences are committed.

In Ireland, the Central Bank of Ireland has the power, with the approval of the Minister for Finance, to make Regulations prescribing an annual Industry Funding Levy ('the levy') to be paid by regulated financial service providers to the Central Bank of Ireland[7]. The purpose of this levy is to fund the relevant proportion of the cost of the annual budget for financial regulation. The balance is funded by the Central Bank of Ireland. The method of calculating a financial service provider's annual levy varies depending on the industry funding category within which the financial service provider falls. The Central Bank of Ireland issues a levy notice to almost all financial service providers after the regulations are made. The levy must be paid no later than 28 days from the date on the levy notice.

In France, the budget of ACPR is mostly covered by the general State budget through a tax on supervised insurance and banking companies, to cover the expenses of their supervision. However, the ACPR has budget autonomy on the basis of this annual amount assigned. The current tax levies level are 0.23‰ of insurers' written premiums and 0.66‰ on banks' minimum legal capital requirements, as defined by the law (*code monétaire et financier*).

In Switzerland, FINMA's costs are covered by the institutions it supervises. It can adjust its cost level where there is a specific need to do so. Supervised institutions are required to pay supervisory fees and levies. User fees are levied individually from each supervised institution and are mainly charged for rulings and supervisory proceedings, and cover the costs of the work carried out by FINMA. Approximately one-fifth of FINMA's annual expenditure (CHF 133 million) was covered by fees in 2017. In contrast, supervisory levies are charged at group level, not individually. The cost of supervision is spread across the individual areas supervised. FINMA covers almost 80% of its operating costs, including allocations to its statutory reserves, through supervisory levies.

In the UK, the Financial Services and Markets Act 2000, as amended by the Financial Services Act 2012, contains provisions that allow PRA and FCA to make rules to raise fees, in order to allow them to fulfil their statutory objectives. The FCA collect the fees for both institutions. For the PRA, there are six categories of prudentially regulated firms, or 'fee blocks.' The amount payable by each fee block depends on the budgeted cost of prudentially regulating that category of firms. Within each category, the fee payable by an individual firm depends on the size of its business. Firms that could cause the greatest

[6] The legal foundation for this is the Act Establishing the Federal Financial Supervisory Authority (*Finanzdienstleistungsaufsichtsgesetz – FinDAG*).

[7] Central Bank Reform Act, 2010.

harm to the stability of the UK financial system will be the main contributors to the funding needs.
Many insurance regulators that are funded by the industry can be attributed to the regulator and supervisor being the same institution (Argentina, Belgium, Canada, Egypt, Hong Kong China, Israel, Italy, Latvia, Luxembourg, Nicaragua, Panama, Peru, the Philippines, Portugal, Romania, South Africa, Sri Lanka, Tunisia, United Kingdom)

4.1.3. Supervisory independence

M 96. **Supervisory independence:** an insurance supervisor should be independent in deciding enforcement actions based on a rules- or principles-based sanction and intervention process, and for this statutory protection of supervisors should be established. Supervisory independence includes the legal protection of supervisors to ensure that they can take action without fear of legal action (suit) being taken. Having a board or head of supervisor that is independent, and makes decisions based on expert analysis and understanding is also important in maintaining supervisory independence.

R 97. Supervisory independence is the core and main tenant of an independent financial supervisor, relative to institutional and budgetary independence which are also elements of an independent financial supervisor, as it safeguards the integrity of the supervisory function. It is also considered to be more difficult to establish and guarantee than other aspects of independence.

Enforcement

M 98. The imposition of enforcement measures presents the insurance supervisor with powerful and direct powers. To balance and manage this with the need of supervisors to take timely action that is commensurate with the risk and size of the financial institutions, it is essential that supervisors establish procedures that provide guidance on how this can be undertaken and the accountability measures for when they are taken.

M 99. A good enforcement regime is premised on guidance being laid out clearly on inspections and supervisory guidance is well developed, allowing better interpretation by the financial market of when and how enforcement action will be taken. Since enforcement actions are based on violation of the applicable law, this is an important issue that needs to be recognised.

Q
- Has sufficient and appropriate supervisory guidance been developed to enable supervised entities to fully comprehend the expectations with regards to compliance?
- Has there been interpretative guidance on when and how enforcement action may be taken?

ICP 1.2 Primary legislation clearly determines the objectives of insurance supervision and these include at least to:

- protect policyholders;
- promote the maintenance of a fair, safe and stable insurance market; and
- contribute to financial stability.

ICP 2.4 The supervisor has effective internal governance structures, processes and procedures to preserve the integrity of its actions and decisions and to enable it to account to its stakeholders.

ICP 2.5 The supervisor applies requirements and supervisory procedures consistently and equitably.

M 100. The ability of a supervisor to take **enforcement action** when a regulation or rule was not followed, and having an appropriate level of enforcement action relative to the weakness or infringement of the insurer are important to ensure that supervised entities can take remedial actions promptly and appropriately.

M 101. There should be available a progressive list of enforcement actions so as to incentivise supervised entities to remedy any situation swiftly, so as to avoid additional and stronger enforcement action being taken.

CP 10 Preventive Measures, Corrective Measures and Sanctions

The supervisor:

- requires and enforces preventive and corrective measures; and
- imposes sanctions

which are timely, necessary to achieve the objectives of insurance supervision, and based on clear, objective, consistent, and publicly disclosed general criteria.

ICP 10.4 The supervisor:

- requires the insurer to take actions that address the supervisor's identified concerns;
- periodically checks that the insurer is taking action; and
- assesses the effectiveness of the insurer's actions.

ICP 10.5 The supervisor escalates, including enforcing, preventive or corrective measures if its concerns are not addressed by the insurer's actions.

ICP 10.6 The supervisor imposes sanctions on insurers and individuals proportionate to the breach of regulatory requirements or other misconduct..

R 102. The most common action is corrective measures or instructions/recommendations, and decisions can usually be appealed.

R 103. The next relevant action is penalties, fines and sanctions, which would likely all involve monetary payment by the regulated entity against non-compliance. Penalties can usually be appealed against.

R 104. Suspension of license is when the permission of a regulated entity to enter into new insurance contracts is suspended for a certain period of time, while the withdrawal of a license takes place when the license is cancelled and the regulated entity is not permitted to operate any longer. In some jurisdictions, an insurance authority can withdraw a license only when the insurer has settled all obligations with all clients. The run-off of existing insurance business requires an insurance license in some countries. Decisions on suspension of license can usually be appealed.

M 105. Many countries also include warnings and administrative takeover of insurer in the list of potential actions

M 106. Transparency of the process is essential and disclosure of the actions are obligatory to ensure accountability of the procedure.

M 107. There should be clear procedures on when and how supervisory actions can be challenged. The procedure should ensure that supervisory independence is not violated and/or can be sufficiently maintained.

Q
- Is there an early warning system to indicate to supervised entities that they may become subject to enforcement action?
- Is there clarity of when a supervised entity is found with a weakness or non-compliance, the list of potential actions that will be taken and its progression?
- How and when can a supervised entity appeal the decision taken, and is there a clear timetable for this?

FINMA states that its enforcement actions are for the purpose of ensuring that compliance with law is restored.
FCA investigates and commits resource to a substantial number of investigations and cases involving suspected unauthorised business, which occurs outside the regulatory perimeter as part of its “credible deterrence” approach. More importantly, the Enforcement Review notes that “enforcement has a general deterrence value”. To this extent, FCA has referral criteria which set out when an investigation could be launched, which is when a firm or individual may have breached one or more of the rules or if there appears to be circumstances suggesting that there may have been a breach.[8] The FCA has an Enforcement Guide[9] which sets out the procedures in detail, and then the Decision Procedure and Penalties Manual[10] which establishes how decisions are made.
In Japan, a more direct approach is taken to enforcement action with “[t]he size, nationality, and type of business of the financial institutions involved do not affect[ing] FSA decisions”.[11]

[8] FCA, Referral criteria at https://www.fca.org.uk/about/enforcement/referral-criteria.

[9] FCA, Enforcement Guide as part of FCA Handbook. https://www.handbook.fca.org.uk/handbook/EG.

[10] FCA, Decision Procedure and Penalties Manual (DEPP) as part of FCA Handbook at https://www.handbook.fca.org.uk/handbook/DEPP.

[11] JFSA, Administrative Action in the Financial Sector https://www.fsa.go.jp/en/refer/guide/action.html.

Procedures for appointment of head and board of a supervisor

R 108. Insurance (financial) sector supervisor may be governed by a head, a board of director, a commission s or a supervisory council.

M 109. In most countries, the process for the appointment of a head or members to the governing body of the supervisor is set out in legislation. Typically, the legislation will include requirements for legislative or executive confirmation of appointees, expectation of expertise, length of term, term limitation and grounds for dismissal. It is essential that the qualification and experience of the head or board is highly relevant, ensuring that confidence can be engendered in their decisions.

M 110. The nomination of a head or board member may be based on a recommendation from the supervisor or from the government/minister. The appointment itself will most likely be made by the government/minister. Most important is that the appointee has the necessary expertise and experience to be appointed and this can be verified in an objective manner.

M 111. The government should not be able to dismiss the head or board members of the supervisor before the end of their term unless they are incapacitated, criminally charged, or an otherwise legitimate reason not related to their role as supervisor. This is a crucial aspect of both institutional and supervisory independence.

Q
- What are the qualifications for a head or board member of the supervisor?
- Who nominates candidates for head or board member of the supervisor?
- Who appoints the head or board member of the supervisor?
- Are the conditions in which dismal is permitted made clear and reasonable given the need for independence of the supervisor?

ICP 2.3 Procedures regarding the appointment and dismissal of the head of the supervisor and members of its governing body (if such a governing body exists) are transparent.

M 112. If there is a board, the expertise represented on it should reflect the areas the supervisor monitors, and the board should be a diverse group of people in terms of skillsets and perspectives.

FINMA has a management structure with a board of directors, an executive board and an external auditor in the form of the Swiss Federal Audit Office (SFAO). As FINMA's strategic management body and in accordance with the Financial Market Supervision Act, the Board of Directors comprises seven to nine independent expert members. It decides on matters of substantial importance, issues ordinances and circulars, and is responsible for FINMA's budget. It also ensures internal controls by means of an internal audit unit and oversees the Executive Board. The operative business is managed by the Executive Board, which is made up of nine members: a chief executive officer and the eight heads of the respective divisions. The Executive Board prepares the necessary files and materials for decisions to be taken by the Board of Directors and is responsible for implementing the resolutions of this management body. For all matters that do not fall to the Board of Directors, the Executive Board reaches its own decisions. FINMA’s Board elects the Chief Executive Officer, whose appointment must be confirmed by the Federal

Council. It also elects the other members of the Executive Board, with the Chief Executive Officer being granted the right to propose candidates for membership.
In the Netherlands, the DNB is managed by its Governing Board, which pursuant to the Bank Act 1998 consists of a President and three to five Executive Directors. The President and the other Governing Board members are appointed by Royal Decree for seven-year tenures. Governing Board members can be reappointed once to the same position. Pursuant to the Bank Act, the Supervisory Board consists of seven to ten members. Supervisory Board members are appointed by the shareholder[12] from a list of appointees drawn up by the Supervisory Board. They are appointed for four-year tenures and can be reappointed. One Supervisory Board member has a special position, being government-appointed by the Minister of Finance. This member acts as a liaison between DNB and the Minister of Finance and is authorised to make enquiries with the Governing Board about DNB's performance of its tasks with a view to notifying the Minister.
In France, there are parity gender requirements on two of the supervisor's governing bodies (the supervisory board and the sanction board).

Legal protection

M 113. Legal protection is part of supervisory independence, so insurance supervisors can execute their supervisory function fully based on a rules-based system of sanctions and interventions without fear of legal action being taken against their actions.

R 114. Only when appeal processes or other recourse options have been exhausted should any legal action be allowed against the supervisor, and only if the action was not taken in good faith.

M 115. The supervisor should be protected from legal action, other than judicial review, for supervisory action taken in **good faith**.

M 116. In the event that legal action is taken, the supervisor should try to avoid action being taken against an individual staff supervisor, direct any against action to be made towards the institution or the head/board of the supervisor.

M 117. There are two main means through which legal protection has been provided in countries. The first (basic) is covering any legal costs that are associated with suits brought against the supervisor. This could be covered by a reserve account or the purchase of liability insurance.

M 118. The second, and more important, means is to have statutory protection against liability for actions taken and omissions made in good faith while discharging their duties. Legal actions taken against the supervisor not only uses precious resources of the supervisor, but also creates an environment of uncertainty and excessive sensitivity in taking supervisory and enforcement actions.

R 119. Having both financial resources as well as protection against liability would ensure that a supervisor can execute their responsibilities without fear of legal action.

[12] The Dutch State is DNB's sole shareholder, represented at general meetings by the Minister of Finance.

Q

- Is there an effective appeals process for supervised entities to take against supervisory and enforcement actions?
- Have there been occasions in which legal action has been taken against the supervisor? If so, was this against good faith supervisory decisions or not?
- Is there a reserve fund to cover legal expenses?
- Does the supervisory have protection against liability in the statutes?

ICP 2.2 Legislation governing the supervisor provides the necessary legal protection from legal action against the supervisor and its staff for actions taken in good faith while discharging their duties. In addition, the supervisor's staff is adequately protected against the costs of defending their actions.
Financial Stability Board's *Key Attributes of Effective Resolution Regimes for Financial Institutions* indicates in principle 2.6 (and 4.4, sub [ii]) that the "resolution authority and its staff should be protected *against liability* for actions taken and omissions made while discharging their duties in the exercise of resolution powers in good faith, including actions in support of foreign resolution proceedings."
Financial supervisors (with responsibility for insurance supervision) with special rules governing their liability include Austria,[13] Estonia,[14] Germany,[15] Ireland,[16] Lithuania,[17] and the UK.[18] Australia[19], Canada[20], Singapore[21] and South Africa.[22]

[13] Federal Act on the Establishment and Organization of the Financial Market Authority (FMABG 97/2001). Article 3.

[14] Financial Supervision Act 2001 (RT I 2001, 48, 267), sec 52.

[15] As BaFin is a public law body, its liability is based on the German Civil Code. In addition, to reduce the possibility of individual claims against the supervisory authority, the German government stated, in § 4(4) *Finanzdienstleistungsaufsichtsgesetz* (Financial Services Supervision Act), that BaFin performs its financial supervision only in the general public interest. As a result, in the absence of a specific and targeted duty of care, BaFin is immune from claims by third parties.

[16] Section 33AJ of the Central Banking Act deals with the liability of the Central Bank of Ireland, providing the Central Bank 'is not liable for damages for anything done or omitted in the performance or purported performance or exercise of any of its functions or powers, unless it is proved that the act or omission was in bad faith'.

[17] Article 461 (1) of the Law on the Bank of Lithuania 1994 (No I-678 as last amended by No XI-557) states: The damage caused by the illegal actions of the Bank of Lithuania or Bank of Lithuania staff in relation to the performance of the supervisory function of credit institutions and payment institutions shall be reimbursed only in the case where the person who has suffered the damage proves the Bank of Lithuania or Bank of Lithuania staff guilty of such damage. There is no case law in Lithuania in which the Lithuanian financial supervisory authorities have been held liable.

[18] In the Financial Services and Markets Act (FSMA) of 2000 (2000 c 8). Schedule 1 para 19 of the FMSA limits the liability of the FSA (or currently the PRA or FCA) to 'acts in bad faith' as well as acts that breach Convention rights incorporated into English law by the Human Rights Act 1998 (1998 c 42).

[19] Australian Prudential Regulation Authority Act 1998 (Cth) sec. 58.

[20] Banking Regulation Act 1949, sec 54.

[21] Monetary Authority of Singapore Act, ch 186, sec 22.

[22] The Banks Act 1990 (Act No 94 of 1990) sec 88.

4.1.4. Crisis situation

M 120. Have scope for the independence of the insurance supervisor to be overridden (*e.g.,* in a crisis situation) with triggers and conditions pre-defined. Some of the conditions and who can make this decisions should be clearly set out so that undue skirting of the supervisor's independence can be avoided.

Q
- Have there been crisis or other situations in which the supervisor needed to take actively part in government action, requiring better coordination of supervisory actions with government actions?
- What are the triggers for this to be invoked and who makes these decisions?

4.2. Accountability

M 121. An independent insurance (financial) supervisor is accountable for its actions and subject to scrutiny by designated authorities, which in most cases would be the ministers of finance or economy.

R 122. Accountability is applicable to insurance supervisors, and in their role as insurance regulators, but are generally not applicable to policy-oriented regulators who are often part of the executive branch. If an insurance regulator is set up as an independent agency, however, the following considerations would become applicable.

M 123. Accountability fulfils four functions:

- provide public oversight,
- maintain and enhance legitimacy,
- enhance integrity of public sector governance, and
- improve agency performance.

Germany: while BaFin (the financial supervisor) is operationally independent, the German constitution requires that the decisions by the executive branch must not be taken by bodies outside of parliamentary control. Thus, the control of BaFin is guaranteed via the legal and supervisory control of the Ministry of Finance, which is in turn is controlled by the German parliament

M 124. To ensure its roles and functions are based on delegated authority and it can address whole-of-government concerns where necessary, accountability measures, both *ex ante* and *ex post,* should be discussed with the responsible ministry.

R 125. *Ex ante* measures would pertain to strategic planning of activities and coordination, while *ex post* measures would consist of reporting on the outcome of activities against the objectives and priorities that are set.

R 126. To strengthen the accountability of insurance authorities, the following considerations should be born in mind:

- Formal accountability is more optimal to ensure institutional responsibility for its actions and decisions, provide public oversight, maintain and enhance legitimacy, enhance integrity of public sector governance, and improve agency performance.
- Accountability can be enhanced by transparency and public disclosure, where the insurance authority's objectives, frameworks, decisions and their rationale, data and other information are provided to stakeholders in a comprehensive, accessible and timely manner.
- In addition to accountability, integrity of an insurance authority can be further enhanced by having a clear procedure for appointment of heads, their terms of office and criteria for removal.
- Integrity of the insurance authority's day-to-day operation can be safeguarded by internal audit arrangements and standards for conduct of personal affairs of officials and staff to prevent conflicts of interest.

ICP 2.8 The supervisor is transparent to the public, supervised entities and the government about how it exercises its responsibilities.

4.2.1. Measures of accountability

M 127. Preconditions of good accountability of an insurance authority include but are not limited to:

- A clear legal basis of its powers and functions, preferably set out in its statute;
- Clear objectives that describe its basic purposes;
- Clearly defined relationship between the insurance authority and the executive branch;
- Security of tenure for the officials of the authority as well as stipulations on who can appoint and dismiss senior officials and under what conditions.

M 128. There are four main avenues in which accountability can be achieved, particularly in relation to branches of the government:

- Procedures by which the agency can be held accountable to the **parliament** from which it has delegated authority (where relevant);
- An **open decision-making procedure** for transparency purpose; and
- It is held accountable for the way it manages its **finances**; and
- The insurance authority may be subject to **judicial review** with respect to the manner in which it exercises its power. This judicial review should be clearly specified and defined.

R 129. General measures of accountability for insurance supervisors include:

- Reporting to parliament (this is usually to the relevant parliamentary committee or designated parliamentary body)

The President of the Belgian FSMA is part of an annual hearing in the Belgian Parliament.
In the United Kingdom, insurance supervisors are (i) required to make appearances before relevant Parliamentary Select Committees; (ii) subject to internal evaluations through the Independent Evaluation Office; (iii) accountable to and /overseen by the Bank of England 'Court'; (iv) accountable through judicial review, where appropriate, by the High Court of England and Wales; and (v) accountable to Her Majesty's Treasury.
The Korean FSS/FSC is subject to an oversight hearing by the National Assembly
The Central Bank of Russia is subject to a State Duma hearing

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- Oversight and reporting to a government agency, which is by default led by an elected or appointed official.

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- Meeting with responsible ministry to discuss strategic planning and receive input on government views on prudential supervision.

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- Appeals process against supervisory decisions

ICP 2.6 There are processes to appeal against supervisory decisions which do not unduly impede the ability of the supervisor to make timely interventions in order to protect policyholders’ interests or contribute to financial stability.

R
- Budget approval

R
- Budget reporting: this could be the responsible ministry, government accountability agency, or to the public.

In Luxembourg, the annual accounts require approval by the government.

R
- Public hearings

R
- Public disclosure regime: speeches, annual report, publication of decisions

The Italian IVASS president and board members make speeches and participate in hearings to describe the objectives and needs of IVASS.
Insurance authorities often publish their annual report and related update publicly as well (Austria, National Bank of Belgium, Belize, Bolivia, Brazil, Chile, Colombian Financial Superintendent, Egypt, Finland, France, Germany, Hong Kong China, Israel, Italy, Japan, Mexico, Peru, Poland, Portugal, Russia Ministry of Finance, Spain, Sweden, Tunisia, Uruguay, Vanuatu

R • Audit: by a national agency or an internal audit process. If by a national agency, auditing may either be financial in nature or examine the administration and management of the authority.

In Canada, the OSFI is subject to the oversight of the Auditor General of Canada
In Costa Rica, the supervisor annually reports to the General Comptroller's Office
Denmark, the Danish FSA reports to the National Audit Office
The Japanese FSA is subject to audits by the government Board of Audit of Japan, as well as being subject to information disclosure requests
The Korean FSC/FSS is subject to audit by the government Board of Audit and Inspection
The Latvian Financial and Capital Markets Commission must submit full accounts audited by a sworn auditor
In Mexico, CNSF and the SHCP are subject to external audit performed by Congress through the Auditoría Superior de la Federación (the Federal Auditor)
The National Audit Office carries out an audit of the Swedish Finansinspektionen
The Russian Audit Chamber of the Russian Federation audits the Central Bank
The Insurance Board of Sri Lanka is audited by the Department of Government Audit as an external auditor, and the Internal Audit Department, Ministry of Finance & Mass Media as an internal auditor

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