Approach to Insurance Regulation
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1. Executive Summary

The Gibraltar Financial Services Commission (GFSC) published its first strategic plan in October 2014 and this set out our programme for the period 2014-2017. This is the first regulatory approach document that has been produced specifically for insurance, in recognition of the importance of this sector and builds upon the wider GFSC strategic plan. Our focus over the last 3 years has been the preparation for, and the implementation of, Solvency II. The aim of this document is to set out our expectations and the focus of regulatory attention to support and ensure that we have a growing, vibrant, well governed and sufficiently capitalised sector. We intend to update our strategy over time in the future, and therefore we welcome discussions with industry as we progress the areas of this plan.

Gibraltar is a net exporter of financial services into the UK and the European Union (EU) and insurance is one of the largest financial services sectors within the jurisdiction. We currently have 62 licensed insurance companies (of which 42 are active) who have a combined gross written premium (GWP) of circa £4.8bn. Almost all of this business is written in countries outside of Gibraltar, with the largest being the UK, comprising approximately £4.4bn. Gibraltar companies also write business in other EU countries, the largest being France, Italy, Ireland and Spain.

Insurers provide promises to policyholders that their products will help mitigate specific risks when a loss event occurs, whether at a corporate or on a personal level. We want to ensure that our regulated insurers have the financial capability to meet those promises as and when they are called upon (Prudential Risk), and that the products they are selling are meeting policyholder requirements (Conduct Risk).

Despite a significant expansion in headcount over the last three years, the GFSC remains small enough to deploy an agile approach in our regulatory remit supported by the proximity of our CEO and senior management team to frontline regulatory staff and the industry. We adopt a risk-based approach to insurance regulation with the ability to adapt our approach quickly to reflect emerging firm and market issues.

This regulatory strategy will be delivered through more detailed and risk based work plans in each of the following regulatory functions:

- Authorisation of new insurance companies, material changes to business plans and on-going fitness and propriety assessments
- Supervision of prudential requirements of insurance companies
- Supervision of conduct of business
- Legal, Policy and Enforcement

Each of these areas of focus is supported by allocated and dedicated resources within the GFSC, and a communications strategy to ensure that the industry and all relevant stakeholders are clear on the detail of our expectations. We intend on delivering clear, concise and consistent messages across to the industry covering all our areas of focus. We have established good information sharing forums with the Government of Gibraltar and senior industry decision makers, as well as interested stakeholders in other jurisdictions and supervisory bodies. The accessibility to key individuals in the jurisdiction and insurance companies means information can be shared and disseminated quickly, and feedback on proposed initiatives received and considered in a timely manner. We also intend to manage communication with firms that we consider not to be meeting regulatory requirements in a consistent manner across the industry.

The performance of a company operating effectively and in line with our expectations is underpinned by its approach to governance and its business model. We set out our expectations for these areas in sections 4.1. and 4.2.
We have developed a variety of supervisory tools that can be used as part of our on-going supervision of firms. We will continue to use these tools and enhance how they are used to assist in identifying and directing our regulatory resources to the higher risk insurers or issues identified through the analysis of information we receive.

Stakeholders can expect to see a willingness to use “active” supervisory tools including: intensive on-site reviews, skilled person’s reviews and the appointment of inspectors. These will be in circumstances where the use of these tools is necessary to understand and contain significant risks. We are aware that these tools present costs to firms, sometimes significant, but will only be used when necessary and where there is no other acceptable alternative. These tools are discussed in section 4.4.2.

We have established an intensive supervision team (IST), whose key focus will be to supervise those firms that either pose greater regulatory concerns or which appear to be facing significant challenges in the near future. We discuss this as part of our supervisory approach in section 4.5.

In Prudential supervision, we assess whether insurers have appropriate systems, processes and controls in place to safeguard the interests of policyholders through the general supervision of the application of the Solvency II regime. We will focus on areas including risk management, underwriting, reserving, investments, reinsurance, the solvency capital requirement (SCR) and economic capital, own funds and group contagion. We are implementing work streams for each of these areas. We expect firms to address all of these areas in their governance frameworks and their Own Risk and Solvency Assessments (ORSAs). Firms should also factor in the specific risk issues not captured by the Solvency Capital Requirement in their own assessment of economic capital. These areas are discussed within section 4.5.

Solvency II has introduced a number of new aspects of quantitative and qualitative reporting, and has increased the overall amount of reporting we receive. We have developed data analytics systems that allow for the manipulation and analysis of the large volumes of data, enabling us to track key ratios and trends on a timely basis. A base level of review of all our insurance firms has been developed which will identify outliers and risk indicators that can then be followed up in more detail. We discuss reporting in section 4.5.10.

This supervisory plan also includes the supervision of those professional service providers who provide critical services to insurance companies and/or deliver key documents we rely on as part of our supervisory process, such as auditors and actuaries. We will work with supervisory authorities and governing bodies of these industries to ensure that the services they provide are suitable to supporting our regulatory efforts. We discuss the supervision of auditors and actuaries in sections 4.5.13 and 4.5.14.

Whilst our approach to regulation prioritises early identification of risks and addressing these through appropriate and timely action from both firms and us, we also need to prepare for occasions where firms decide to cease trading or where further regulatory intervention is required. It is important that insurance companies have assessed various scenarios where this type of action might be required by identifying pre-described examples of the circumstances that could lead to further action being required by senior management or the Board, and that those who are required to implement them understand the mechanisms for both recovery and resolution. Recovery and resolution planning is discussed in section 4.5.12.

Over the last few years, we have prioritised prudential matters and the implementation of Solvency II within insurance supervision. Whilst prudential matters will remain of fundamental importance, we will devote more time and resources to insurance conduct of business as discussed in section 4.6. We will build upon the opportunities presented by the implementation of the Insurance Distribution Directive in October 2018 to develop and further enhance our conduct supervision activities. This includes the
appointment of a new Head of Conduct of Business in April 2018 and additional experienced insurance conduct supervision staff.

An important element of our authorisation and supervision approach is to work closely with other competent authorities, including host state regulators and European supervisory bodies, to ensure that we have an appreciation of the regulatory landscape in the jurisdictions where Gibraltar insurance companies are operating. This will continue and be enhanced throughout the life of this supervisory plan. Our regulatory and international collaboration is discussed in section 6.

We will also continue to be accessible to applicants and open to new and innovative business models. In particular, our CEO and senior management team are very close to the authorisations process, and are always available to meet applicants at all stages of the authorisations process.

The pre-application process together with the access to our experts and key decision makers allows us to eliminate companies that will not be within our risk tolerance levels and give speed to market access to those that do, at an early stage. Our authorisation processes are discussed in section 4.3.

Our approach to enforcement is underpinned by a desire to encourage and facilitate compliance with regulatory principles and requirements. We provide guidance and deal with issues whilst seeking to achieve appropriate outcomes via our enforcement actions. The access our enforcement team has to senior management benefits our decision-making and leads to strong actions. In doing so, we will ensure that we deliver a credible deterrent in our enforcement activity. Our enforcement approach is discussed in section 4.7.

Our policy team works closely with the other areas of the GFSC to continue the development and implementation of regulatory policy and standards, keeping pace with change ensuring the delivery of effective regulation of insurance companies in Gibraltar. Post Brexit, we intend to monitor developments in the UK, EU and internationally so that our legislative and regulatory framework remains contemporary delivering regulatory best practice. Our policy approach is discussed in section 5.

2. Introduction

Our aim as regulators is to supervise how insurance companies address prudential and conduct of business risks and we have therefore set out in this document the strategy we will be adopting over the next 18-24 months in order to explain the challenges faced within the insurance sector, our expectation of firms and our regulatory approach to these.

The Gibraltar insurance sector comprises 62 insurance companies (analysed in the table below) and a gross written premium (GWP) of circa £4.8bn. Almost all of this business was written in countries outside of Gibraltar, with the largest being the UK, which comprised approximately £4.4bn. Of this amount, approximately 75% consisted of UK motor policies. The largest other EU countries in which Gibraltar insurers provide insurance policies were France (£151.5m), Italy (£64.3m), Ireland (£50.5m), Greece (£18.9m) and Spain (£18.7m).

42 Active Insurers writing new business split as follows:

<table>
<thead>
<tr>
<th>Insurance Type</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Open market non-life insurance companies</td>
<td>33</td>
</tr>
<tr>
<td>Captive insurance companies</td>
<td>6</td>
</tr>
<tr>
<td>Life insurance companies</td>
<td>3</td>
</tr>
</tbody>
</table>
Gibraltar Financial Services Commission

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20 companies no longer actively writing business split as follows:

<table>
<thead>
<tr>
<th>Category</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Companies in liquidation</td>
<td>5</td>
</tr>
<tr>
<td>Open market companies in run-off</td>
<td>8</td>
</tr>
<tr>
<td>Captive companies in run-off</td>
<td>4</td>
</tr>
<tr>
<td>Companies not writing new business (but not yet in formal run-off)</td>
<td>3</td>
</tr>
</tbody>
</table>

Priority for 2014-2017 had been on the implementation of Solvency II; this was the largest change to insurance regulation in a generation – highly complex from a technical perspective, time consuming and expensive to implement. One impact of Solvency II has been the significant increase of the amount of regulatory capital that insurance companies need to hold to continue to do business. One of our key objectives was therefore to ensure that firms understood the challenge being faced and to work with them to ensure that they were meeting the new requirements as soon as possible – without the need to access transitional provisions. The majority of firms licensed in Gibraltar succeeded in meeting the new capital requirements, with only a small number of firms going into run-off or requiring transitional relief going into 2016. All firms that are continuing to underwrite new business are now meeting the new Solvency II capital requirements.

Whilst it is good news that our firms have been able to overcome the challenge of adopting Solvency II successfully, the business environment for most of our firms is still challenging. We therefore need to continue to work with the industry to ensure that firms continue to meet their capital requirements, the methodology applied in calculating those capital requirements is appropriate, good governance and management practices are adopted, and that firms have sustainable business models.

Now that Solvency II has been implemented and in operation for almost two years, we have developed and enhanced our conduct of business supervisory approach and have recruited a new Head of Conduct of Business to lead and deliver this further development work.

We have established an intensive supervision team (IST) within Prudential, whose key focus will be supervision of firms that either pose greater regulatory concerns or appear to be facing significant challenges in the near future. Areas targeted by the IST vary from firm to firm, whether it be capital, governance, reserving or other business model issues. The aim of this intensive supervision is for the firm to address and rectify weaknesses identified, in a timely manner.

If firms are unwilling or unable to achieve this, we will seek targeted regulatory action using the variety of supervisory tools at our disposal, including enforcement action. This may include directing the firm to cease writing new business, with the objective of protecting existing business, and preventing putting further policyholders at risk. In such circumstances, our aim is always, where possible, to ensure that the firm is subject to a controlled and solvent run-off.
3. The GFSC’s objectives and the insurance industry

We are the regulator of an international financial services centre, regulating providers of financial services in both Gibraltar, Europe and other jurisdictions.

Our statutory regulatory objectives are:

- The promotion of market confidence.
- The reduction of systemic risk.
- The promotion of public awareness.
- The protection of the good reputation of Gibraltar.
- The protection of consumers.
- The reduction of financial crime.

In addition, as an organisation we have the following eight overarching objectives:

1. To position the organisation in a way which supports both the Government of Gibraltar and the financial services industry to successfully and safely navigate the jurisdiction’s exit from the EU and carefully manage the implications this may have for financial services providers and their customers, wherever they are located.

2. To develop, and build on existing, trusted partnerships both with UK authorities as well as other regulators, authorities and international standard setting bodies and make meaningful contributions to the work of these bodies.

3. To attract and retain the regulators of tomorrow, through the early identification and development of technical and behavioural capacity.

4. To be considered a strong source of regulatory expertise, both in the new and innovative sectors we are regulating, as well as in those existing sectors that continue to be important to Gibraltar.

5. To be recognised as a leading regulator of new innovation, responsively and strongly supporting the safe use of financial and regulatory technology.

6. To be at particularly aware of the role innovation can play in adding value to the delivery of financial services to consumers, both in terms of choice and quality.

7. To be recognised as a leading regulator of new innovation, responsively and strongly supporting the safe use of financial and regulatory technology.

8. To continue to build a reputation for swiftly identifying and managing out bad business, ensuring that we protect consumers wherever they are located and the reputation of Gibraltar.

This document sets out our approach over the next 18-24 months towards advancing and achieving these objectives in respect of the Gibraltar insurance industry. Below is our overall approach that we will be taking in the insurance sector covering our three main functions of Authorisations, Supervision, and Enforcement over the life of this supervisory plan. These functions are further expanded upon below:

- Our **authorisations** function will encourage new applicants of good quality, and deter and refuse applicants where risks posed are outside of our risk tolerance (section 4.3).

- Our **supervisory** function (both prudential and conduct) will focus on the timely identification of whether an insurer is posing or risks posing a threat to policyholders. Where we have identified
risks, we will seek to work co-operatively with insurers to reach an acceptable outcome (sections 4.4 to 4.6).

- Where we see that an insurance company does not have the willingness or capability to rectify a particular situation, our supervisory team will work in conjunction with our enforcement function to safely contain the risk to policyholders (section 4.7).

All three functions will clearly communicate expectations to the insurance industry and potential applicants.

Experience tells us that the critical elements for having a well-run and appropriately capitalised insurance company, and for this to continue to be the case, are strong governance and a sound and sustainable business model. The majority, if not all problems observed historically in the insurance industry, can be linked to a failure of either one or both of these two key areas. Our supervision will therefore focus on these two critical elements as a starting point, before looking at other detailed areas set out in this supervisory plan. Given the importance of governance and a firm’s business model, we have developed the following minimum expectations for insurance companies within Gibraltar.

**Governance:**

1. The insurer is run by individuals of integrity, who behave with professionalism.
2. The Board composition and the personalities on the board are appropriate, and there are good quality experienced Non-Executive Directors (NEDs) who are able to firmly challenge executive management and positively contribute to the decisions made by the Board.
3. There is clear accountability in the system of governance, with conflicts of interests managed appropriately and with the right level of expertise in key roles.
4. Those governing the company are able to demonstrate experience behind their business plans, that these plans are realistic, and that they have been sufficiently challenged.
5. Individuals in the company engage with us in an open, co-operative and timely manner and must disclose to us any matter of which we would reasonably expect notice.

**The business model:**

6. The business model is realistic, based on sound and achievable business assumptions and makes good business sense overall.
7. The company’s operations are run competently and prudently.
8. The company is able to accurately determine what constitutes a sufficient and appropriate level of capital.
9. The company has continuing access to adequate levels of capital, with contingency plans and recovery options in times of stress.
10. There are clear, sound economic reasons for setting up the company in Gibraltar.
11. Outsourcing is well managed and supervised and contingency plans are in place for key outsourcing arrangements.
12. From a conduct of business perspective, the company’s products are properly designed, distributed and appropriate to meet the insurance needs of its customers and that they are not misled i.e. the policy that customers have bought, performs in a way that they thought it would.
13. The company is resolvable, with proportionate contingency plans for the orderly and solvent wind down of its business

4. Regulatory Approach

Our regulatory approach is conducted through our three main functions of Authorisations (section 4.3), Supervision (sections 4.4 to 4.6), and Enforcement (section 4.7). We initially discuss governance (section 4.1) and business model analysis (section 4.2), due to their fundamental importance in the insurance sector and their span across each of our three main functions. Within Supervision we discuss our supervisory approach (section 4.4), before focussing on specific prudential (section 4.5) and conduct of business supervision areas (sections 4.6).

4.1 Governance

Our experience shows that a root cause of high impact company failures is poor governance. Good corporate governance is central to a well-led and managed insurance company and ensures that the promises to policyholders are kept and responsibilities to them are met.

4.1.1. Board composition

For an organisation to be well run, appropriately capitalised, and report in line with requirements, there needs to be strong systems of governance embedded within the insurance company and monitored by the organisation’s governing body. We expect systems of governance to embed the requirements and principles within pillar 2 of Solvency II.

Our principle objectives in respect of corporate governance is to have prudently run and managed insurance companies authorised and supervised in the jurisdiction, that have a transparent relationship with the regulator with an open and honest culture.

Assessing the governance structure and its appropriateness to an organisation is a continuous obligation for the Board of insurance companies. We perform an assessment of governance at the initial authorisation stage and review this on an on-going basis, including changes to individuals on the Board, in Controllers or Managers. There is also an assessment of the appropriateness of the governing body of the organisation as a whole when applications are made for material changes to business plans.

Our key consideration is whether the governing body collectively possesses the knowledge, skills, competence, and experience to operate in the markets that they are seeking to access. We also consider whether the governing body has an appreciation of their regulatory obligations, and that the policyholder should be at the centre of their decision-making.

We interview new potential Board members at application or notification stages to get an understanding of the tone within the governing body, including the Board dynamics, and an insight into how they will operate in practice. We may also periodically interview Board members as part of our ongoing supervision. Over the period of this supervisory plan, applicants and licensees will experience an increased frequency of interviews when there is an application for a notified role holder. In addition, there will be more discussions with Boards on their dynamics and suitability for the business being written.
Board independence

One critical aspect of governance is that there are independent non-executive directors, who are not connected to the entity or provide services to the entity, to enable there to be adequate challenge of the decisions being made. It is also equally important that Boards make a periodic assessment of the independence of non-executive directors after they have served a number of years on the Board. The appointment of new non-executive directors, or the rotation of non-executives, allows for new individuals to bring new perspectives, experiences and knowledge to assist the firm in meeting new challenges and improve existing processes and controls within the organisation. Where non-executives continue serving for a large number of years, we expect Boards to determine whether they remain independent formally, and to justify reasons as to why there is no rotation. We will work collaboratively with Boards at the point of re-assessment of business plans and as part of our annual supervisory reviews to evaluate the independence of Board members.

Further information on the GFSC’s Core Principles for Corporate Governance and Board and Firm independence can be found on the following link: Corporate Governance Presentation and Transcript Notes.

4.1.2. Fitness and propriety expectations

We have an obligation to ensure that all licensees, role-holders and controllers/shareholders demonstrate, continue to act with, honesty, integrity and professionalism, and do not pose a risk to the public or the jurisdiction. Such fitness and propriety requirements are fundamental to our Authorisations, Supervisory and Enforcement functions.

The fit and proper persons’ test considers a range of key factors focused around three basic elements:

- Honesty, Integrity and Reputation
- Competence and Capability
- Financial position

We will also take account of the activities an individual is performing or intends to perform, the licence or permission held or to be held, and the markets within which they operate.

The Authorisations function uses the fitness and propriety requirements to assess individuals applying for licences, seeking appointment in notifiable roles or acquiring certain holdings in licensed entities. In the context of authorisation, the burden of demonstrating fitness and propriety will rest on the individual concerned. The Supervisory function uses the requirements when looking at ongoing conduct. The Enforcement function uses the requirements as part of its investigation process to help assess whether a firm, licensee, notifiable role holder or controller/shareholder no longer meets the statutory requirements for holding the licence, notifiable role or ownership interest.

Failure to meet requirements

The failure by a licensee, notifiable role holder or controller/shareholder to meet the fitness and propriety requirements can be expected to result in refusal of a licence or an application, revocation of a licence, authorisation or status as a notifiable role holder or controller/shareholder or other regulatory action by us, including enforcement action. Senior management presence on the committee responsible for considering such action leads to quick decisions and decisive action where necessary.
**Ongoing reporting**

All licensees, notifiable role holders or controllers/shareholders are required to continue to meet the fitness and propriety requirements on an ongoing basis. If there is a change in an individual’s circumstances that may cause us to consider that the individual has fallen below the fitness and propriety threshold, the individual must promptly notify us. Failure to do so will be regarded as lack of honesty and integrity in the individuals and/or firms’ dealings with the GFSC.

**4.2. Business model analysis**

Whilst our experience shows that poor corporate governance is the main root cause in high impact insurance company failures, having an inadequate business model, including those that have failed to adapt with time to the changing business environment, are a significant contributor to those failures. Some examples of where we have recently identified issues in this area are:

- Insurance companies that make consistent underwriting losses.
- Insurance groups or clusters of connected parties where profits are made outside the insurance company.
- Inappropriate levels of intra-group debts and lack of liquidity.
- Inappropriate systems and controls to manage a business with a variety of introducers and books of business.
- Insufficient capital to support the business that the directors wish to undertake.

We consider business models on a holistic basis. This includes an assessment of whether the underlying business lines are profitable, how the company has structured its activities (including the outsourcing of activities and whether a common ownership approach as opposed to a group structure has been adopted), and how the business model addresses key risk areas (underwriting, reserving, capital, systems and data, conduct, etc.).

Assessment of the business model is a key part of our Supervisory Approach, described in section 4.4.

**4.3. Authorisations**

We aim to deliver a streamlined and seamless authorisation process supported by our quick, agile decision-making process and appropriate appeal mechanisms. Our assessment of risks at the application stage will focus on ensuring that any new entrant does not pose an unacceptable degree of risk to the public or the reputation of Gibraltar, whilst avoiding the creation of unnecessary regulatory barriers and the stifling of competition. This is largely achieved through the accessibility of senior decision makers in the organisation through a decision-making committee that meets twice a week, and the strength of insurance expertise at senior level.

**4.3.1. New insurance company approvals**

As a jurisdiction, Gibraltar has committed to speed to market, and open and continuous engagement with our applicants. In order to deliver on these commitments, we have implemented a robust, yet targeted authorisations approach for new insurance companies to cover the critical areas of risk in a timely manner, at pre-application stage or at the beginning of an application process rather than towards the end. We offer potential applicants the opportunity to go through a pre-application process with key senior individuals from the insurance team to help identify material areas of weakness, concern, or complexity in an application at an early stage. We will also continue to be accessible to applicants and open to new
and innovative business models. Our CEO and senior management team are particularly very close to the authorisations process, and are always available to meet applicants at all stages of the authorisation process.

The pre-application process together with access to our experts and key decision makers allows us to eliminate companies who will not be within our risk tolerance levels and give speed to market access to those that do at an early stage. When reviewing new insurance company applications, the Authorisations function focuses on five key areas:

1. Governance and controls
2. Conduct of business requirements
3. Capital adequacy, including access to further capital
4. Rationale for setting up in Gibraltar
5. Sustainability of business model

Once a potential applicant decides to go ahead with an application, we aim to put milestone plans in place for the application process so that both sides are aware of the timescales for delivery and review. Both parties work towards the mutually agreed objectives.

The pre-application process is critical to our commitment of speed to market. Potential applicants experience regular pre-application meetings with senior industry experts to identify risks outside of our risk tolerance early on in the process.

Below are key areas of an application that we consider at the pre-application stage and throughout the assessment of an application.

1. **Governance and controls**

Our expectations of the governance framework in an organisation have been discussed above in section 4.1.

We also consider the processes and controls over underwriting, risk management, claims and compliance and outsourcing as follows:

i. **Underwriting**

We look for clear ownership of the underwriting process within the firm, including that:

- Premium income will cover expected claims and expenses.
- Customers are informed properly about the product they are buying.
- Risks of underwriting are identified, including potential legal changes that may affect claims costs; optionality and guarantees in products.

If underwriting is delegated, this does not remove the responsibility for underwriting. The firm should set up regular monitoring (including audits) of the entity to which underwriting is delegated in order to assess compliance with underwriting guidelines, limits, and the effectiveness of the delegation. To summarise, the insurer should be able to demonstrate that it has carried out due diligence on a delegated underwriter and is satisfied that the characteristics of a “good insurer” as detailed above are applicable to the delegated underwriter.
ii. Risk management

We will look for clear risk management processes that identify, measure, manage, monitor and mitigate risks including:

- Developing a clear risk appetite and risk metrics (including tolerances) for the firm that are used in monitoring risk, risk mitigation and other decisions such as investments.
- Reporting to the Board at each meeting regarding any risks in the firm and changes to them.

A well-capitalised, well-run insurer can clearly write more risky classes of business provided it has demonstrated that it has risk management processes that appropriately identify, measure, manage, monitor and mitigate risks.

Note that in the normal course of supervision, the GFSC’s role does not extend to approving individual risk selection.

iii. Claims and compliance (processes and people)

We look for clear ownership of claims handling and compliance in the firm – including:

- complaints handling policies (incorporating the definition of a complaint) supported by effective procedures for; logging; analysing and responding to complaints within a timely manner and providing clear information to consumers on the firm’s complaint process and their rights.
- understanding of the implications of any outsourcing of the claims process (covered in more detail below).
- consumer impact.
- costs, especially if in run-off.
- clear link to actuarial reporting, and understanding and ownership of the impact of data quality on the balance sheet.

If claims handling is delegated, this does not remove the responsibility for claims. The firm should set up regular audits of the entity to which claims handling and settlement is delegated in order to assess compliance with claims handling guidelines, limits and the effectiveness of the delegation.

iv. Outsourcing

The GFSC has clear guidance on outsourcing that aligns with the EIOPA guidelines on the system of governance. Applicants and their advisers should review these. Key areas for review in an application include:

- Ownership
- Data flows
- Access to records
- Ownership of records
- Checking of compliance with and monitoring of outsourcing contracts
A key aspect for the GFSC is that a firm should have individuals within it who are responsible for monitoring the performance of outsourced operations, and are able to flag issues or potential issues to the Board between Board meetings.

2. Conduct of business requirements and understanding

As part of our assessment of an application, we want to ensure that the company places appropriate priority on conduct of business requirements, considering these from a customer perspective, and demonstrates a detailed understanding of the regulatory conduct of business requirements in the countries in which it operates and distributes its product as a minimum. Ultimately, we expect firms to have effective policies and procedures in place that ensure transparency, simplicity and fairness for their consumers.

We note that the business models may include outsourcing of front line customer service, such as policy administration and claims handling. However, we consider that responsibility for good consumer outcomes rests with the risk carrier, i.e. the insurer. This means that our assessment will include reviewing the governance and controls in these areas. We pay particular attention to a firm’s conduct risk framework, i.e. whether the firm has effective governance arrangements in place to identify the risk of harm to consumers and markets, and whether they have a strategy in place to manage and mitigate those risks.

For example, we may review firms’ plans to use complaints as useful data on the customer experience. We expect firms to look down the customer value chain and take control of information obtained from the beginning to the end of the chain.

3. Capital adequacy, including access to further capital

We note that there is research on the purpose of regulatory capital, including a paper from the International Actuarial Association, who note that an effectively defined capital requirement serves several purposes such as:

- Providing a rainy day fund, so when bad things happen, there is money to cover them.
- Motivating a company to avoid undesirable levels of risk (from a policyholder perspective).
- Promoting a risk measurement and management culture within a company, to the extent that the capital requirements are a function of actual economic risk.
- Providing a tool for supervisors to assume control of a failed or failing company.
- Alerting supervisors of emerging trends in the market.
- Ensuring that the insurance portfolio of a troubled insurer can be transferred to another carrier with high certainty.

We also note that adequate capital alone is not a sufficient mitigation of the risk of failure, and that it is a necessary complement to good governance, systems and controls.
When assessing capital requirements against available capital for a new insurer, we consider, in line with the Acts and the Regulations, that:

- Available capital must be appropriately loss absorbing.
- An applicant should assess how much capital it needs to start up and to cover both potential future growth plans including the typical claims development pattern for the classes of business it wishes to underwrite.
- The proposed available capital links closely to the risks in the business. This means that an application should include a clear statement of the risk appetite and link the proposed available capital to that risk appetite, including an appropriate buffer above regulatory capital requirements (the Solvency II Solvency Capital Requirement - SCR).
- Further capital is available in case of need, for example, after a period of losses. Here we will consider support from shareholders, a parent company or group companies.

We note that the Acts require insurance companies to hold basic own funds above the SCR, and that a firm’s own assessment of capital in their Own Risk and Solvency Assessment (ORSA) cannot be used as a regulatory capital requirement. However, we would also note that insurers should be run by a board whose members understand their risk appetite. This includes assessing capital needed for the risks in the balance sheet.

We understand that the amount of capital needed to cover risks in the balance sheet will be above the SCR. We also note that the SCR is a trigger point for regulatory action, rather than a recommended amount of capital to hold. As part of our assessment of governance in an applicant and the fitness and propriety of the board, we will be assessing understanding of this point.

Additionally, we will be assessing the appropriateness of the proposed buffer above the SCR, and for firms planning to write compulsory classes of business we will require an independent validation of the buffer.

4. Rationale for setting up in Gibraltar

Where applicants wish to set up locally, they must demonstrate that there is a sound economic reason why Gibraltar is the right jurisdiction for them to set up their company. This will include an analysis of where all the critical functions of the organisation are located and the assessment of where the head office is located.

5. Head office assessment

We understand that where there is harmonisation of regulation and because of the implementation of that regulation, it becomes less onerous to access other markets operating using similar frameworks. However, to be regulated by us, Boards must be able to show, that despite global access to people and services, the key decision-making apparatus and key functions are being discharged from Gibraltar. Whilst there is limited guidance on what this is expected to look like, we believe that the Board in Gibraltar must make critical strategic decisions and that role holders spend a sufficient proportion of their time in Gibraltar.
As part of the four criteria noted above, there is increased engagement with potential applicants on these areas as part of the pre-application stage, so that unacceptable risks can be identified early on in the process.

4.3.2. Material changes to business models

Authorised insurance companies may make changes to their business model or business plan over time, resulting in the operations of the company appearing to be significantly different to initial approvals made during the application process. Where a firm makes a material change to their business plan, approval from the GFSC is required prior to effecting that change. There is no set definition of what constitutes a “material change to a business model”, as this will vary from firm to firm. We understand that any change requiring Board discussion or approval within a firm is likely to constitute a material change to a business model. Equally, a series of small changes made that, when combined, significantly impact the business plan would also be considered as a major change.

As part of our review of material changes to business plans/models, the authorisations function will re-consider the governance processes in place in the context of the new operations. We will also re-consider the adequacy of the Board and the key outsourced providers resulting from the changes proposed.

We encourage firms to have discussions with their supervisory contact around what might constitute a material change for them and on the informational requirements of a material change. Where there is a material change requiring approval, we will engage with senior management promptly in order to facilitate a timely decision on approval or on any conditions of approval.

4.3.3. Authorised persons and Solvency II Key Function Holders (KFH)

Given that the governance of a firm is key to the successful operation of an insurance company, firms are required to notify us of who the Solvency II KFH are, as well as those other roles which constitute Notifiable Positions under Gibraltar legislation, such as directors, shareholder/controllers and managers. We expect these individuals to discharge their responsibilities adequately in accordance with the standards expected of those in these roles.

We are working on legislation with the Government of Gibraltar to introduce an “individually-regulated persons’ regime”, similar to the UK approved persons and senior persons’ regime but tailored to the Gibraltar market. We believe this will allow us to interact in a more constructive manner with the individuals captured so that standards of behaviour are maintained at a suitably high level.

Solvency II Key Function Holders

The Solvency II Directive has introduced the role of Key Function Holder (KFH) for the four key functions of actuarial, risk management, internal audit, and compliance. Due to their role in coordinating key tasks that facilitate good governance within an insurance company, appointed KFH are required to be fit and proper.

On relevant regulatory matters, we expect to have increased direct engagement with the KFH. Where we have concerns with the conduct of the KFH, we may discuss with the insurer the ongoing suitability of the appointed role holder. We will also carry out our own authorisations assessment when new KFH are appointed.
While we consider outsourcing of operational tasks of the key functions to be permissible, we currently require the key function holder to be employed within the insurance company\(^1\) or a related service company. Where tasks are outsourced, there is an obligation on the role holder to ensure that the scope of the outsourcing is appropriate (to enable the KFH to fulfil the delegated tasks in a comprehensive manner). This is to be able to challenge any output from the outsourced provider, and to ensure that any recommendations or stated limitations of the outsourced provider are followed up and dealt with appropriately.

We expect the KFH to be part of the individually regulated persons’ regime. As part of this new regime, we may consider whether it is appropriate to outsource the role of a KFH wholly.

**4.4 Supervisory Approach**

**4.4.1. Risk evaluation for insurers**

In this plan, we commit to delivering a focused approach to supervision, supported by risk based policies and processes. We take a proportionate approach to supervision allowing us to focus on the major issues and material risks across the insurance industry or within specific firms, and to be proactive in taking action or intervening, as appropriate, in a timely and decisive manner.

The driving principles that underpin our risk based approach to supervision are that:

1. The level and type of supervision proportionate to the impact and likelihood of policyholders experiencing significant detriment as a result of a failure or from purchasing poor products or poor service more generally.

2. The level and type of supervision a firm receives will be reviewed by a panel of senior GFSC staff, at time intervals based on the risk rating of the firm or at such time when a new or emerging material risk is identified, or the nature and scale of the firm’s business changes.

3. A proportionate and tailored supervisory engagement plan will be developed for each licensee.

When assessing the risk in Insurance firms, as described above, we will focus on the following areas:

- Governance – including:
  - Management and controls
  - Risk culture and controls
  - Financial crime systems and controls

- Business model analysis - including:
  - Prudential risk
  - Conduct of business

This assessment was operationally implemented through our supervisory process. We are identifying and implementing changes to the process to further enhance the process, to ensure that more senior management time is focused on our higher risk or more impactful firms, and that supervisory action is taken in a more decisive and timely manner. The review will also consider whether alternative processes could be put in place for lower risk firms, for example extending the 12-month cycle for firms falling into this category.

\(^{1}\) Or, where the individual sits within a service company or other group company, to have a contract in place so that their key function work is demonstrably taking place within the insurance company.
4.4.2. Supervisory tools

We have a variety of supervisory tools that can be used as part of our on-going supervision of firms – as set out in the Financial Services (Insurance Companies) Act 1987 and in the transposed Solvency II Directive (Financial Services (Insurance Companies) (Solvency II Directive) Act 2015, some of which we set out below.

This is in addition to the regular on-going supervision of firms through information that we receive (either as part of the firm’s regular or ad-hoc reporting), including:

- Regular financial reporting – Audited financial statements, Solvency II quantitative reporting templates (QRTs), solvency and financial condition reports (SFCRs), regular supervisory reports (RSRs), and firms’ management accounts;
- Own Risk and Solvency Assessments (ORSAs) and business plans – on an annual or ad-hoc basis due to material changes in business;
- Notification documents – licence extensions, passporting notifications, or changes in notified persons;
- Other reporting – e.g. complaints reports; and
- Regular update meetings with senior management at the firm.

We will continue to use this information and enhance how it is used to assist in identifying and directing our regulatory resources to the higher risk issues and insurers.

We use the new supervisory powers provided by the Solvency II Directive in our supervisory approach, including:

- Review of implementation and the internal reporting of a firm’s systems of governance, and in particular of the KFH for internal audit, risk management, actuarial, and compliance.
- Adequacy of technical provisions and the power to set these at level in accordance with appropriate actuarial methods where we consider those set by the firm to be inadequate.
- Capital add-ons, where we consider: a) the capital derived and required by the standard formula does not appropriately or adequately reflect the level risk faced by the firm; or b) there are significant deviations from the expected standards of systems of governance.

The Insurance Distribution Directive came into force in October 2018, and we communicated to the industry how we expect to use our powers under this Directive.

We make more use of “active” supervisory tools such as on-site reviews, skilled person’s reviews and the appointment of inspectors, where our normal on-going supervision has identified significant risks that require investigation that is more detailed. Our agile decision-making structure means that we can tailor our approach to the specific circumstances and react quickly to new information.

- On-site reviews - We continue to use on-site reviews for insurers where we have identified particular issues that need further, detailed follow-up or investigation. On-site reviews will take place at the firm’s offices following the provision of information on the areas being reviewed. We continue to use this tool to target specific areas of concern, and usually conduct an intensive, focused on-site visit, with the length depending on the number and complexity of the issues being covered. A report with recommended courses of actions to be taken by the firm with associated timeframes for completion will be produced after an on-site review has taken place. Recent on-
sites have focused on delegated underwriting, business model analysis and related parties’ or intra-group transactions.

- Skilled persons and/or inspectors - We make more use of skilled persons and inspectors as part of our supervisory toolkit where normal on-going supervision has identified risks that require more investigation that is detailed. The appointment of skilled persons and inspectors and their respective uses are set out in the Financial Services (information and Gathering and Co-operation) Act 2013 in section 7 and sections 8 to 11 respectively. The skilled person will be appointed by and report to the firm and we will set the scope in conjunction with the firm. The appointment of the inspector is different in that the GFSC appoint the inspector to carry out work and will report to the GFSC, the scope of the work will also be set by the GFSC. In both instances, the cost of the work will be borne by the firm.

We have used both of these tools in 2017 and 2018 and have found them to be an invaluable additional technical resource to conduct specific pieces of work such as corporate governance, reserving (for specific classes of business and countries), delegated underwriting and resolution and contingency or resolution planning. We continue to use these tools to provide an independent expert view, particularly in difficult or complex technical matters (structural or financial arrangements); or where there continues to be significant differences between our regulatory position and that held by the firm on regulatory areas critical to the financial well-being of a firm.

4.5. Prudential supervision

We want to ensure that our authorised insurers have the financial capability to meet the obligations to policyholders and claimants against any insurance policies they have issued. We supervise this by focusing on key areas set out in this section. Our expectations are also set out against each of these areas. Where new best practice emerges, we will communicate this to industry through further publications and established information sharing channels.

Across these key areas, we recognise the importance of outsourcing for many Gibraltar insurers, to service providers, related companies, and delegated authorities to distribution or claims handling companies. Where outsourcing exists, the oversight and governance of outsourcing arrangements will be of key considerations. Under Solvency II, undertakings must ensure that the outsourcing of critical activities does not materially impair the quality of the system of governance.

We have split Prudential into two separate sections, the intensive supervision team (IST) and business as usual (BAU). IST focus their attention on a small number of high risk firms, with the aim of resolving the specific issues faced by firms in that category in a short timeframe and reporting weekly to senior management. This real time attention by senior management means that we are able to be highly responsive to changes in circumstances and new developments. For certain firms, this may include focused intervention up to and including the use of enforcement action. Following a successful pilot within the insurance sector, we have implemented this approach for other industry sectors.

The BAU team focus their attention on the remaining firms supervised by Prudential and these firms are further categorised (Tier 1 to 3) according to their respective risk and impact, with more supervisory attention directed to firms classified as tier 1. The intention is that firms in IST that have had their issues successfully resolved will move into BAU, whilst firms that are in BAU may move into IST, should issues warrant this.

Below are key areas of focus for prudential supervision.
4.5.1. Risk Management Framework and Processes

Firms are expected to have robust risk management frameworks and processes in place. These are visible to the GFSC where firms discuss and address their risks within their Own Risks and Solvency Assessment (ORSA) document, and the rigorousness applied to the risk management framework by the firm. This includes how often the risk register is reviewed, who is involved, how new events and risks are captured, risk tolerances and ongoing monitoring, and the steps that the Board take to mitigate key risks. The application of the firm’s risk management framework and processes will be reviewed throughout the insurance supervisory process, including targeted review of ORSA’s.

4.5.2. Underwriting

We consider adequate underwriting processes and controls to be an essential requirement for running a financially sound insurance company. Inadequate pricing and underwriting can cause insurance companies to take on excessive risk, and can put significant strain on their solvency position. Underwriting considerations include pricing, risk selection, policy coverage, exclusions, endorsements, and aggregation management.

Firms are expected to monitor underwriting performance on a regular basis, and should be in a position to react effectively to any material changes in market conditions. This includes reviewing the ongoing appropriateness of underwriting appetite and pricing, ensuring there is an ability to make timely underwriting changes (for example, subsequent to the March 2017 Ogden rate change), and considering potential underwriting impacts due to strategic changes from key distributors, service providers, and competitors.

Firms are also expected to consider underwriting requirements for forward looking business plans and whether the overall business model of the entity is profitable. In particular, we will robustly challenge significant improvements in forecast underwriting performance or overly optimistic loss ratios and expect these to be based on comprehensive and robust analysis, particularly where this is not supported by historical actual performance. We will request further justification in cases where the rationale for these changes is not clearly outlined in the business plan or ORSA or does not start with the actuarially determined loss ratio from the prior year.

4.5.3. Reserving

The reserving process and reserve adequacy are key to a firm’s financial soundness due to the uncertainties and subjectivity inherent in forecasting insurance liabilities. In accordance with the requirements of the Solvency II Directive, we expect to see evidence that technical provisions are calculated in a prudent, reliable and objective manner, based upon credible, accurate and current data, include realistic assumptions, and calculated in accordance with relevant actuarial and statistical methods. We will assess actuarial function holder reports, independent actuarial reports, and relevant committee and Board minutes in order to assess the appropriateness of the reserves, the adequacy of the reserving process and the challenge provided by the Board during this process.

We consider independent actuarial reports to be an important aspect of reserving governance. Expectations on the use of independent actuarial reports were set out in the ‘Dear CEO’ letter of 15 March 2017 ‘Key areas of focus for insurance company Boards’. Expectations include that an independent reserving report should cover all business lines – live and discontinued\(^2\) - and that a firm ensures that, for each relevant class of business, the selected actuaries have the relevant class of business and jurisdiction

\(^2\) Unless it can be adequately justified why certain lines do not need independent review and are out of scope, and this justification has the express consent of the Board.
knowledge. In line with good governance practices, we ordinarily expect that Boards should reserve at least to the independent actuary’s best estimate (in particular when a firm does not have its own in-house actuarial expertise). We also expect a documented reconciliation available between the actuarial projections of the independent reserving report and those booked in the financial statements and Solvency II balance sheet. We would not expect firms to reserve at levels outside the independent actuary’s best estimate unless a significant amount of analysis has been undertaken and that the differences can be supported by quantitative and qualitative analysis. Where a firm decides to reserve below an independent actuary’s best estimate, we expect to be notified of this fact.

The responsibilities of the appointed Actuarial Function Holder and of actuaries working for Gibraltar firms are discussed in section 4.5.14.

4.5.4. Investments

The investment strategies which insurance firms put in place have wide reaching implications for the firm and the ability of the firm to generate investment returns, meet policyholder and company obligations and ensure that the company is sufficiently liquid at all times.

We expect firms to give due consideration to the Prudent Person Principles of Solvency II and to have a well-documented and cohesive investment strategy that considers all aspects of the firm’s Governance and supervisory requirements.

As part of the ongoing monitoring of insurance companies, we review the allocation of investments held by firms and any significant fluctuations in the asset mix which are not consistent with both the Prudent Person Principles and the documented investment strategy of the firm. We also identify firms which have unusual or outlier investment strategies on a risk basis, the liquidity profile of the investment portfolio and asset mix, and conduct more detailed reviews of these with appropriate regulatory action taken where any further concerns are identified.

4.5.5. Reinsurance

We recognise that reinsurance often plays an important part in the risk management strategies of insurers. Reinsurance structures may have a considerable variability in their design, and may include limits, commission’s structures, and other contractual clauses, which alter or reduce the full extent of effective risk transfer provided. Reinsurance arrangements by implication therefore introduce additional counterparty and liquidity risk to a firm. Should these reinsurers fail or where the reinsurance cover is not adequate, there may be a direct impact on the financial soundness of the insurance company.

We will consider the financial strength and credit ratings of an insurer’s selection of reinsurers. We expect there to be risk appetites and exposure management around this section. Where reinsurance counterparty exposures are material, an insurer’s assessment of a reinsurer’s financial strength and ongoing counterparty risk, may need to look beyond only the credit rating, which could change over the duration of a reinsurance exposure.

We expect that firms give full consideration to the specific nature of reinsurance structures and any reinsurance concentrations within their ORSA reports, particularly as part of stress, scenario, reverse stress testing, standard formula appropriateness assessments, and as part of economic capital considerations. We will pay particular attention to those situations where a firm has increased their reinsurance programme for reasons of capital management and review whether any limits of risk transfer are appropriately reflected within a firm’s SCR and economic capital. We continue to focus on loss portfolio transfers, adverse development cover reinsurance contracts, and sliding scale commission
structures within reinsurance contracts. We expect specific consideration by firms of these types of insurance contracts within their ORSA documents and their calculation of economic capital.

Where information is absent from the ORSA, we may request further information and analysis, particularly where reinsurance contracts play a material part in a firm’s capital management strategy. These information requests may include more comprehensive details of reinsurance structures, the underlying reinsurance contracts and targeted ORSA re-submissions.

4.5.6. Group contagion

Intra group and connected party arrangements within insurance groups or insurance companies with "close links" to other entities can create contagion risks that might not necessarily be addressed by Standard Formula capital requirements. We consider that it is necessary for us to understand group structures, the need for arrangements in place with other related parties, and that there is appropriate and sufficient reporting to understand the risks associated with these arrangements.

We will consider those groups with material intra-group or related party transactions and assess both the reasonableness of the arrangements involved as well as the contagion and counterparty risks where there are amounts due to the insurer. In particular, we will consider the following: how companies consider the economic value of amounts and impairment, and build this into their ORSA’s; the impact that related party balances have on the liquidity of the firm; the reasonableness of fees charged for services; and the oversight of outsourced arrangements.

Where significant risks are identified that have not been or cannot be adequately mitigated in their current form, we will approach and work with those insurance groups so that arrangements are restructured. Restructured arrangements will ensure that overall risk to the insurance company and policyholder interests are reduced or additional capital is held (i.e. the SCR buffer is increased) to mitigate the exposure to such arrangements.

We will also consider whether there are any risks posed from the funding structure of a group.

In addition to reviewing information provided by insurance groups, we will consider whether current level of reporting of intra-group transactions under Solvency II is sufficient or whether further data and reporting is required to identify potential risks at an earlier stage.

We may also periodically assess Solvency II group classifications, to ensure that reporting requirements and regulatory obligations remain appropriate to the group structure and the overall business model of the group.

4.5.7. Solvency Capital Requirement (SCR) and appropriateness

We expect firms to continually monitor and assess their level of capital and solvency cover to safeguard its policyholders, to support objectives set out in its business plan. We monitor the SCR and Minimum Capital Requirement (MCR) of firms on an on ongoing basis as well as performing more in depth assessments on a periodic basis.

The ORSA prepared by insurance companies is expected to include an analysis of the firm’s risk profile and an assessment of the appropriateness of the SCR, informed by relevant and sufficiently severe stress testing. The SCR should be sufficient for the insurer to withstand losses at a 99.5% percentile (1-in-200 year) confidence level, including those loss types that may not be explicitly captured by the Standard Formula.

We expect firms to apply stress tests to their capital position so that they can weather unforeseen losses without breaching their SCR and to set an appropriate buffer for managing this so that the company can absorb these potential losses in times of stress. We consider good practice to be in place when a firm sets
both a target and minimum level of capital coverage, where the minimum level is a trigger for management actions.

Adopting an inappropriate method of SCR calculation and/or not considering the SCR appropriateness can put policyholders at risk. In market feedback, we have stated a number of risk areas that are not well captured by the standard formula, as such it is expected that firms develop stress tests in order to determine their own economic capital needs. This includes the aspects discussed above on investment strategy concentrations, reinsurance, and group contagion.

Where the risk profile deviates significantly from the standard formula, we will engage with firms to ensure that applicable and adequate modelling is carried out. Where risks emerge, we would expect immediate management action from a firm to reduce the risk, or, where this is not possible or immediately practical, we expect firms to work with us as we initiate capital add-on proceedings.

Where we have granted approval for an internal model, undertaking specific parameters, or any other SCR related approvals (e.g. volatility adjustment), we expect firms to carry out on-going appropriateness assessments, at least annually, and more frequently if a change in risk profile is required.

If a firm is considering applying for a new approval, they should engage with their supervisory contact early on in the process to discuss our expectations and the nature of the applications process.

4.5.8. Own funds

In addition to assessing the adequacy of a firm’s level of capital through the SCR calculation, we will also consider the quality of a capital being held through the composition of own funds. Firms are required to meet the requirements of own funds eligibility and tiering. Due to the possible variability on the precise contractual clauses of own funds items, we expect firms to have documented this eligibility assessment. As part of this assessment it should be evident that own funds items are sufficiently loss absorbing in times of stress.

Where firms apply for Ancillary Own Funds (AOF) applications, the main supervisory focus has been on the legal enforceability of the contractual mechanism, the willingness to pay, and the recoverability of funds from the counterparty in times of stress. Firms are encouraged to have advanced discussions with their supervisory contact if considering a new AOF application.

4.5.9. Systems and data

Inherent to a company’s ability to manage and monitor its pricing and reserving adequacy is the quality of the underlying systems and data. We remind firms that they are required to meet Solvency II Directive requirements on data completeness, accuracy, and appropriateness. Having inaccurate or incomplete data can lead to errors in many aspects of the firm’s reporting, SCR calculations, and reserving. These errors are considered an indicator of a failure in governance. We will monitor firm submissions, restatements, and errors identified, and will follow this up directly with firms where considered necessary.

4.5.10. Quantitative and qualitative reporting

We utilise all financial reporting within our supervisory approach. This includes the Solvency II Quantitative Reporting Templates (QRTs), public Solvency and Financial Condition Reports (SFCRs), the private Regular Supervisory Reports (RSRs), Own Risk and Solvency Assessment (ORSA) reports, Annual audited financial statements, and any further bespoke and ad-hoc reporting requested of specific reports. Over this supervisory plan, we expect to focus greater supervisory resource towards QRTs, ORSAs and Actuarial reports and reconciliations.
QRTs and data analytics

Under Solvency II, the amount of data reported to us has increased significantly. Additionally, the consistency and quality of the data reported has also improved due to the inbuilt logic checks within the reporting portals including the use of consistent templates across the EU. Data analytics and the ability to manipulate this data has therefore become an even more important facet of the work that we will conduct on quarterly and annual submissions. We have already developed systems that allow for the manipulation and analysis of large volumes of data points submitted, which is then presented in an easy to understand format allowing us to track key ratios and trends on a timely basis.

A base level of review of all our insurance firms has been developed to identify outliers and risk indicators that can then be followed up in more detail by BAU. This base level of review will also include data integrity checks to ensure the data makes sense and does not deviate significantly from what we expect to see based on ongoing supervisory activities as well as the quality assurance activities that have already been performed.

ORSA reviews

We consider the ORSA review to be a key aspect of Solvency II. It is an important document allowing the communication of key business and risk features to the Board and the regulator. The ORSA process and report should demonstrate and evidence the Board’s ownership and engagement in business planning, economic capital considerations and capital planning, risk management and risk appetite, stress testing, governance, and the overall review of a firm’s business.

On a risk-based assessment, we will review the ORSAs of licenced insurance companies and compare these both against the information gathered by other supervisory activities, guidance issued by us on best practice for ORSAs, and focus areas that have been communicated by us to firms. We expect to focus on the firm’s assessment of economic capital (as highlighted throughout this document), SCR appropriateness, and stress tests performed. Any queries or concerns of a significant nature will be followed up and where the ORSA and information submitted is deemed inadequate, resubmissions will be requested.

4.5.11. Solvency II Quality Assurance

We are committed to delivering on the equivalence of outcomes with our UK counterparts. The process to deliver on the outcome may differ given the size and complexities of the Gibraltar insurance market, but the outcome we expect to achieve will be the same.

There is significant emphasis on the quality of the information being reported in the public domain as investor and policyholder decisions could be based on the information available to them. If this information is incorrect or judgements are being inconsistently applied, it could inappropriately bias decisions of the users of that information. We work with the insurance industry and advisors to focus on material areas of judgement and potential bias within the Solvency II reporting sphere, and on the quality and integrity of the data being used to derive the Solvency II inputs.

On an ongoing basis, we will conduct targeted reviews of assumptions and judgements in order to validate reports, whilst also involving the insurance company’s governing body to demonstrate to us the controls and systems in place to protect the quality of data required for Solvency II reporting.

4.5.12. Recovery and resolution planning

Whilst our approach to regulation prioritises early identification of risks and addressing these through appropriate and timely action from both firms and us, we also need to prepare for occasions where either firms are subject to unexpected events that put pressure on the business model or capital levels, or decide to cease trading.
Our initial focus on recovery and resolution planning for insurers is to ensure clarity on recovery options and of securing a solvent run-off. It is important that insurance companies have assessed various scenarios where this type of action might be required by identifying examples of the circumstances which might lead to the need for management action (for example, through the use of early warning indicators). Insurance companies are expected to ensure that the Board and those who are required to implement them understand mechanisms for both recovery and resolution.

Our expectation is that a recovery and resolution plan will document how a solvent run-off would be secured (that is securing policyholder protection from an operational and financial perspective), and how the risks to this outcome can be managed and mitigated. We have communicated to the insurance industry that there is an expectation for all insurance companies to develop planning and, at a minimum, include details of this within their ORSA documents. The ORSA should clearly set out the recovery options available to a firm and consider those risks that might crystallise in the event of run-off (for example, the recoverability of amounts from major counterparties, any adverse clauses on key outsourcing or reinsurance contracts in run-off, and the mechanisms and any additional costs for claims handling in run-off).

It is one of our minimum expectations for insurance companies that they are resolvable. In the event that we have concerns with regards to the ability of an insurer to achieve a solvent run-off in a stressed scenario, we will escalate the priority placed upon recovery and resolution plans.

We will review of recovery and resolution plans that firms have in place and will rigorously assess the adequacy of those plans including the costs of recovery and resolution plans, access to capital, the ability to sell any pledged assets or other security available, group structures and other economic information.

4.5.13. Supervision of auditors

The role that auditors of insurance companies have in the overall strategic framework for the supervision and oversight of insurance companies is an important one. Auditors will annually perform an in depth assessment of the financial information and records of insurance companies, and are required to highlight in their audit reports issues in the accuracy of the financial data of insurance companies and issues with the ongoing viability of the business through any on-going concern issues. Auditors’ management letters to those charged with governance are also a useful indicator to regulators of potential underlying issues with the systems and controls related to the financial statement reporting process and we expect these to be produced for each firm following the conclusion of the audit.

We expect audit firms to perform audits of insurance companies in accordance with International Standards of Auditing and industry best practice for the insurance sector. Firms are expected to perform their own reviews of experts’ work and conclusions (for example actuarial reports, independent review of the scope, methodology, and projections), and to ensure that the base data used to perform these is consistent with the data the auditor has received for the audit of the financial statements.

We perform periodic quality assurance visits of audit firms and will consider further inspections of audit firms and files where deemed appropriate.

4.5.14. Supervision of actuaries

Reviews of the strength of firms’ actuarial function and the ongoing work of the AFH is carried out internally or is supported by outsourcing. The AFH is required to ensure that tasks of the Solvency II actuarial function are fulfilled. In their report to the Board they should clearly identify any deficiencies and give recommendations as to how such deficiencies should be remedied – with respect to the level of technical provisions, the methodology and assumptions used in calculating technical provisions, the quality and sufficiency of data and supporting systems, and opinions on the firm’s underwriting policy and
reinsurance arrangements. We will consider the quality of the AFH’s reporting and firms’ processes for remedying deficiencies.

Where an actuarial report (either an AFH report or independent reserving report) raises any limitations that are due to a firm’s own processes, such as data limitations we remind firms that it is the responsibility of both the AFH and the Board to consider the materiality of these limitations. These limitations might be addressed when booking reserves, and how processes might need to improve to mitigate such limitations.

In the course of regular supervision, we also consider the quality of outsourced actuarial work provided to firms. We recognise that while the UK Technical Actuarial Standards (TAS) do not formally apply to Gibraltar firms, it may be useful for Boards to request that any commissioned reports comply with the TAS in order to support the quality of reporting and to enhance decision making. We also note that for members of the UK actuarial profession it is a requirement under APS X1 to consider and apply appropriate standards to their work, regardless of where they are located and the work is being carried out.

We recognise that actuarial work is often outsourced to individuals and firms based outside of Gibraltar. In these circumstances, we will engage with overseas authorities and professional bodies, particularly if we have concerns regarding the quality of work being carried out.

4.6. Conduct of Business Supervision

Gibraltar is a net exporter of financial services into the UK and the European Union. Therefore, our objective is to work closely with host state competent authorities to regulate the conduct of Gibraltar domiciled insurers effectively. A risk of inadequate conduct supervision is that customers in host locations may not receive all information required to understand the insurance cover being purchased, or whether the insurance cover is appropriate for their needs.

We have prioritised prudential matters and the implementation of Solvency II within insurance supervision over the last three years. Whist prudential matters remain of fundamental importance; we have devoted more time and resources to insurance conduct of business. We have recruited a Head of Conduct of Business to develop and further enhance our conduct supervision activities and lead on the delivery of this work.

Our approach to conduct supervision will be centred on firms’ policies for treating customers fairly, their products, and ensuring that policyholder interests are at the heart of an insurer’s business. This will be achieved through work streams conducted jointly with host state regulators wherever possible. We will focus on product transparency and methods for sale, so that the insurer guarantees and assumes responsibility for the way in which its products are marketed, distributed and sold to the policyholder, and any other additional services provided (e.g. claims handling).

We expect insurance companies to understand the conduct risks associated with their products and develop a process to identify the risks associated with poor conduct and how these can be mitigated.

Early in the life of this plan we will publish further material on our conduct of business approach and expectations.

4.6.1. Insurance Distribution Directive

With the introduction of the Insurance Distribution Directive (‘IDD’) in February 2018, emphasis on cross border supervision heightened, with a view to benefit from the synergies gained from working with the knowledge and experience of host state regulators. The IDD is a minimum harmonising directive that
requires an understanding of host state regulator rules, particularly where the member state has gone over and above the minimum requirements of the Directive. This heightens the expectations of compliance officers or KFH within an organisation, bringing greater prevalence to the role within an insurance company.

The European Union Commission stated that the purpose of IDD is to improve regulation in the retail insurance market in an efficient manner, with the aim of ensuring a level playing field between all participants involved in the selling of insurance products and the strengthening of policyholder protection.

Similar to the Insurance Mediation Directive (‘IMD’), the IDD covers the initial authorisation, passporting arrangements, and ongoing regulatory requirements for insurance and reinsurance intermediaries. However, the application of the IDD is wider, covering organisational and conduct of business requirements for insurance and reinsurance undertakings.

The IDD also introduces enhanced information and conduct of business requirements where the stated intention is to have closer alignment with customer protections with those provided by the Markets in Financial Instruments Directive II (MiFID II) including:

- Additional knowledge and competency requirements for distributors.
- Product oversight and governance requirements.
- Disclosures around product bundling.
- Additional disclosure requirements in relation to insurance-based investment products.
- Mandated remuneration disclosures - the required disclosures are restricted to the nature of the remuneration and not the absolute amount.

We will be engaging with the industry through working groups and general supervision of licensed entities to assess their readiness in the lead up to implementation. This will also be through collaboration with host member states. Our ability to deliver on the collaboration with industry and other regulatory bodies results from our size and dynamic approach to regulation. As a smaller regulator, there is greater accessibility of senior decision makers in the organisation, enabling more agile decision-making and changes to legislation, where necessary.

4.7. Enforcement process

Our approach to enforcement is underpinned by a desire to encourage and facilitate compliance with regulatory principles and requirements. We provide guidance and deal with perimeter issues whilst seeking to achieve appropriate outcomes via our enforcement actions. The access that our staff has to senior management benefits our decision-making and leads to strong actions. In doing so, we will ensure that we deliver a credible deterrent in our enforcement activity.

We have published our enforcement framework that sets out our strategic approach to enforcement action, our enforcement process and our policies on the threshold for referral, settlement and publication. These documents are available on the Legal, Enforcement & Policy section of our website and set out our enforcement approach in each of these areas in detail.

Where we believe that there has been, or have concerns that there may be or have been a breach of regulatory or other legal requirements, or there is a risk to our regulatory objectives, the insurance supervision and enforcement teams will jointly consider whether a regulatory enforcement response is appropriate.
We will consider this by reference to a range of key factors focused on the merits of the case, the seriousness and impact of the alleged or actual breach, the outcome that enforcement action would achieve, and the overall proportionality. Where a matter is considered appropriate for further investigation and/or enforcement action, the matter is referred from insurance supervision to enforcement.

Our insurance-specific enforcement approach is focused on:

1. Taking timely and effective regulatory intervention action in order to manage immediate risks to our regulatory objectives, including taking preventive action in relation to firms where we consider there to be risks relating to a firm’s business model, reserving or the potential for the deterioration of financial position. We will also take timely regulatory action where firms are considered to be in breach of solvency, licencing or financial reporting requirements.

2. Taking enforcement action to hold to account those individuals who disregard their corporate governance responsibilities and put policyholders, wherever situated, and the reputation of Gibraltar at risk.

In particular, we will not tolerate poor governance, lack of co-operation with us and firms that demonstrate sustained non-compliance with legal and regulatory requirements. Where we have such concerns, we will use the range of our regulatory toolkit as necessary to address this, including the use of skilled persons, inspectors (see also supervisory tools), and the exercise of statutory intervention and enforcement powers.

We may take enforcement action against a firm, an individual or both. Where an individual is personally culpable, we may decide to take enforcement action against that individual in relation to their fitness and propriety.

We have undertaken work internally in strengthening the processes and lines of communication in order to identify and tackle poor behaviours and risks within the regulated community at an early stage. Both Legal and Enforcement liaises with and supports the supervisory teams in identifying the appropriate regulatory response to issues of non-compliance, including the timely and effective escalation of major risks to senior management and to the enforcement and regulatory decision making committees.

5. Making policy to support the GFSC and the Legislative Reform Programme

We have the need to develop policy in respect of individual insurance companies, for example, in relation to specific accounting treatments or the application of Solvency II to some legal structures, where legislation or EU implementing technical standards are ambiguous or a particular situation or set of circumstances is not covered.

We also develop industry wide domestic policy where we become aware of systemic issues. An example would be developing domestic policy on the need for recovery and resolution plans in insurance companies. This is not an EU requirement for all insurers, but is an area where we consider it good risk management for insurers in Gibraltar.

We develop policy in these situations that is in line with the objectives of the GFSC, and is in line with the policy intention of the legislation that we are interpreting. Such policy is developed as needed by individual firms or where we consider there is an industry need. Such policy is developed during discussion between supervisors, our legal team and our policy team, and is discussed and approved by
our senior management team. Policy is also documented, so that future, similar decisions can be made in the light of previous decisions.

Where we consider that previous policies should be revised, we will develop an implementation that allows firms to change their practices in a reasonable time.

Where policy changes are considered by us to be substantial in their effect on firms, we will consult either via relevant trade bodies (for example, the Gibraltar Insurance Association, the Gibraltar Society of Accountants or the Gibraltar Association of Compliance Officers), or more widely via a consultation paper.

Where policy changes are fundamental or require changes to legislation we will, of course, involve GoG at an early stage.

In developing policy, we consider the desired outcome from the policy, and the costs and the benefits, both for the GFSC and for industry.

Our Policy team focuses on the development and maintenance of an appropriate legislative and regulatory framework and is informed by Government policy, our supervisory and enforcement work, market changes and EU and international initiatives. The team are also heavily involved in the Legislative Reform Programme (LRP) to deliver a single consolidated act covering the regulation of all financial and professional services regulated by the Commission, together with a financial and professional services regulatory handbook. The LRP is further intended to ensure that the legislation relating to financial and related professional services is easier to understand, more navigable for practitioners, works in a way that facilitates innovation, supports speed to market and improves the interaction of the various area of financial services legislation. The LRP will deliver major benefits for firms, consumers and new market entrants. Our intention is that firms and consumers alike experience proportionate, effective, risk-based regulation and this should mean that firms’ time, and money is spent mitigating substantive regulatory risks.

6. Regulatory/international collaboration

An important element of our authorisation and supervision approach is to work with other competent authorities, including host state regulators and European supervisory bodies, to ensure that we have an appreciation of the regulatory landscape in the jurisdictions where Gibraltar insurance companies are operating. This enables more targeted supervision of insurance companies and the risks that they pose to policyholders in the host state jurisdiction.

At authorisation level, this means continuous engagement with the prudential and conduct regulators in host states to validate the appropriateness of the business model, the risks posed to customers and whether the host state regulator has any concerns with any of the counterparties being used in their jurisdiction.

We have been spending considerable amounts of resource meeting with and developing relationships with other competent authorities to allow for the prevention of any policyholder detriment in host jurisdictions rather than management of issues in those locations. We were instrumental in working with EIOPA to establish a Passporting Platform and were involved in developing the pilot that is now in use across Europe. This involved meeting at EIOPA to discuss specific firms with other regulators from the jurisdictions where these firms’ passport their services, either on a services or branch basis. In addition, we regularly share information or have calls with our regulatory colleagues to discuss regulatory issues, whether they be firm specific or systemic, that are of mutual interest.
Given the majority of business written by our firms is in the UK, we have regular update calls and face-to-face meetings with our colleagues at the Prudential Regulatory Authority and Financial Conduct Authority to ensure a holistic approach is taken in the supervision of firms that span our two jurisdictions. This will continue and be enhanced throughout the life of this supervisory plan.

7. **Communication to the industry**

Central to our strategy is to ensure that we communicate, to our insurance industry and all relevant stakeholders, the objectives we have for the Gibraltar insurance industry, and the detail of our expectations across prudential and conduct matters. We intend on delivering clear, concise and consistent messages to the industry across all our areas of focus. We also intend to manage communication with those firms that we consider not to be meeting regulatory requirements in a consistent manner.