NON-BANK FINANCIAL INSTITUTIONS REGULATORY AUTHORITY

(NBFIRA)

INSURANCE PRUDENTIAL RULES

In terms of Section 50 of the NBFIRA Act – Section 51 on Reporting

GR2

Financial Condition Report
General Insurance

Effective March 1, 2012

Contents

1. Introduction

1. This document sets out the requirements of NBFIRA ("we") for the submission of a Financial Condition Report ("FCR") from the Boards of insurance companies ("you") that are regulated by us. This is a confidential report to NBFIRA and the details received will not be disclosed to any other parties.

1.1. Purpose of the FCR

2. The Financial Condition Report provides us with an outline of the key risks and matters impacting on the financial condition of you, the insurer. This includes providing us with the implications of issues identified and, where these implications are adverse, proposing recommendations designed to address the issues. It augments, but does not replace, statutory returns.

3. The Board of directors of the general insurer should assure themselves and demonstrate within this report that adequate capital support is in place to minimise the risk of possible financial failure of the insurer.

4. The report should focus on principles. For example, smaller insurers may need to report less than larger insurers.

5. The principles of disclosure that should be adhered to are described in this section. Therefore no standard template is given at this stage.

1.2. Who Must Submit an FCR, and When?

6. All registered general insurers including registered general insurers in run-off must submit a Financial Condition Report.

7. The report must be completed on an individual general insurer level and not at a group level.

8. The report must be submitted to NBFIRA on an annual basis accompanying the annual statutory return BGR1, within four months of the financial year end of the insurer. It should not be viewed as an annexure to the statutory return or the published annual financial statements. Neither should any cross-reference be made between the report and the statutory return or the published annual financial statements.

9. We may at any time require, with valid reasons, a general insurer to compile and submit, within a reasonable period of time, a Financial Condition Report. We may also request this on an ad hoc basis over and above the annual submission requirement depending on the nature of the general insurer's financial position.

10. The FCR must be signed off by the chairperson of the Board of Directors and the Chief Executive Officer of the general insurer.

11. In the event the general insurer was assisted by an Approved Person in compiling any part of the report, the report must state the name and level of assistance provided by the Approved Person.

2. Management, Governance and Controls

2.1. Insurers Background

12. Outline and describe the intrinsic nature of the business and the external environment within which your company operates.

13. Provide details of:

    a. The corporate structure;

    b. The ultimate beneficial shareholder, by including a graph that highlights major shareholders or groups of shareholders, of the insurer as well as the financial condition of the holding company.

2.2. Risk Management Strategy

14. Outline your risk management strategy, including the major risk areas identified.

15. Discuss the systems and procedures in place to identify, assess, mitigate and monitor the risk with which your company is faced.

16. Provide details on the following matters relating to your risk management strategy:

    a. The risk governance roles and responsibilities falling on the Board, Board committees and senior management;

    b. The processes for identifying and assessing risks;

    c. The process for establishing mitigation and control mechanisms for individual risks;

    d. The process for monitoring and reporting risk issues (including communication and escalation mechanisms);

    e. Those persons in the insurer with managerial responsibility for the risk management framework, their positions, roles and responsibilities, and whether there were positional changes during the year;

    f. The process by which the risk management framework is reviewed;

    g. The processes and controls in place ensuring that all business written complies with classes of business registered and registration conditions imposed;

    h. The mechanisms in place for monitoring and ensuring continual compliance with the Prescribed Capital Target (PCT); and

    i. The processes and controls in place for ensuring compliance with all other prudential requirements.

3. Financial Soundness

17. Outline your company's strategy for setting and monitoring capital resources over time and the processes and controls in place to monitor and ensure compliance with the PCT as determined in IPR3.

18. Comment on the following regarding capital strategy,

    a. Targets and trigger ratios included in the strategy;
    b. Any issues arising from the use of the strategy, with regard to the insurer's PCT; and
    c. Future capital needs to support your business plan and specifics about the anticipated sources of capital.

19. Comment on whether or not your company is complying with the PCT, and has complied with the PCT continuously over the past year.

20. Identify trends in your company's compliance with its capital targets over the last three years.

21. If any breaches to the PCT have occurred during the past year the following information must be provided:

    a. The extent of any breaches to the PCT;
    b. Reasons for any breaches to the PCT;
    c. Actions that were taken to rectify any breaches to PCT and whether the breach has been rectified; and
    d. Actions that were taken to prevent such breaches from reoccurring.

22. Comment on your company's capacity to continue to meet the PCT and its capital targets over the next three years; including quantitative and qualitative stress and scenario testing.

4. Prudential Risks

4.1. Underwriting Risk

23. Identify and comment upon significant features or trends in your company's recent experience, providing details of:

    a. The impact of external factors;

    b. Deviations in actual experience from expected experience;

    c. Reasons for these deviations, and

    d. Whether any of the above gave rise or will result in a change of your underwriting policy and to what extent.

24. Comment on any steps taken, or proposed to be taken, by the Board and senior management of the insurer to address areas of deviation and adverse experience.

25. Outline your company's approach to setting premiums, providing details of the areas below. You need not disclose rates or levels, but rather the processes and management structures used to set or allow for each item, and to verify and review them.

    a. Product design

    b. Underwriting practices

    c. The standards applied in the underwriting of risks

    d. Expense assumptions

    e. Actual and expected expenses

    f. Profit margins

    g. The arrangements made as regards reinsurance

    h. The manner in which experience is incorporated into the pricing process

26. Describe how the board and/or management ensure that an effective database is in place to analyze and monitor underwriting data.

27. Provide the following insurance liability information by class of business:

    a. Outstanding claims liabilities i.e. all claims incurred prior to the valuation date, whether or not they have been reported to the insurer; and

    b. Premiums liabilities i.e. all future claim payments arising from future events post the valuation date that are insured under the insurer's existing policies that have not yet expired.

28. Describe the method used to calculate the liabilities, whether this is the prescribed valuation method or another method approved.

29. Provide the following information by class of business:

a. A best-estimate value of the outstanding claims liabilities, split between case reserves for outstanding claims and incurred but not reported (IBNR) reserves;

b. A best-estimate value of the premiums liabilities;

c. An analysis of the historical adequacy of each liability estimate over the past five years; and

d. If the historical provisions have been inadequate, an explanation for these inadequacies and steps taken by the insurer to prevent the situation from persisting needs to be included.

4.2. Market and Liquidity Risk

30. Comment on the current approach of your company to asset and liability management in relation to your liability profile and liquidity needs. Distinguish between assets supporting liabilities and PCT, and those assets supporting surplus assets.

31. Outline the process followed to implement an investment strategy, including the following, specifying as far as possible where the board was involved:

    a. Your investment objective(s);

    b. How the capital position, the term and currency profile of the expected liabilities, liquidity requirements and the expected returns, volatilities and asset class correlations are incorporated in this objective;

    c. The formulation of the investment strategy, discussing strategic asset allocation, assets allocation ranges, risk limits target, currency exposures and ranges;

    d. The management of individual asset classes, whether performed internally or outsourced to investment managers;

    e. The responsibilities of individuals and committees deciding and implementing the investment strategy;

    f. The selection process of the investment managers as well as the monitoring of these investment managers in respect of adherence to their mandates;

    g. The process of ensuring the continuing appropriateness of the investment strategy, including audit and review;

    h. The monitoring of compliance with the investment strategy; and

    i. Contingency plans to mitigate the effects of deteriorating conditions.

32. Outline the strategy for managing and monitoring cashflows for each line of business in order to ensure that liquid assets are sufficient to meet claims and expenses as they fall due.

33. Provide details of any material liquidity problems over the prior reporting period and the processes and procedures in place to diminish the future occurrence of these problems.

34. Provide the following information in respect of derivative transactions:

a. Objective in using derivatives;
b. Risk tolerance or allowed exposure;
c. The management framework in respect of derivative transactions;
d. Lines of authority and responsibility for transacting derivatives;
e. Worst-case scenarios and sensitivity analyses tests;
f. Systems in place to enable the frequent and effective monitoring of positions and able to cope with the volumes and volatility of transactions undertaken; and
g. Details and reasons for any breaches of exposure limits.

4.3. Credit risk

35. Outline the processes in place to manage and monitor the credit risk exposure of your company.

36. Outline those risks which you regard as your main credit risks.

37. Describe how your company defines acceptable ranges, quality and diversification of credit exposures. This should be related to different categories such as reinsurers, brokers, policyholders, investments and other. Describe the board's involvement in setting the insurer's risk tolerance and involvement in setting allowable hedging strategies to offset credit risks.

38. Describe the limits set for credit exposures and the maximum exposure at the reporting date to single counterparties, groups of related counterparties, and specific asset classes.

39. Describe of the process for approving changes in the credit mandate and changes in limit structures.

40. Describe of the process for reviewing and, if necessary, reducing or cancelling exposures to a particular counterparty where it is known to be experiencing problems.

41. Mention whether you have contingency plans to deal with worsening credit risk.

42. State whether your credit risk policies are subject to periodic audit and expert external review and how often.

43. Provide details of any material third-party defaults over the prior reporting period and the processes and procedures in place to mitigate such defaults from reoccurring in the future.

4.4. Operational risk

44. Define what you perceive as operational risks in your business context. Operational risks are the risks associated with failure of people, processes, and systems or due to external events or parties. Some examples include:

    a. Processes: business continuity risk;

    b. People: the risk of inadequate human resources;

    c. People: internal and external fraud;

    d. Processes: the risks associated with project management;

    e. Processes: the risks associated with underwriting and claims;

    f. Processes: the risks around the introduction of new products;

    g. External parties: the risks associated with outsourcing work;

    h. Processes: failure of management information and accounting systems and communication with the board

45. The report needs to provide detail on the processes incorporated by the insurers to manage and monitor the operational risk exposure.

46. Describe the process of identifying and defining key areas of operational risks. Explain how your company's activities and internal functions are reassessed to update the definition.

47. Provide details on the financial losses suffered due to operational losses over the prior reporting period; including:

    a. A description of the events that caused the loss;

    b. The control procedures that were not functioning to prevent the loss; and

    c. Mitigating actions taken to prevent these losses in the future.

4.5. Reinsurance Management Strategy

48. Outline your company's reinsurance management strategy.

49. Comment on any issues arising from the use of the specified reinsurance strategy and arrangements, including:

    a. The primary objectives when placing reinsurance;

    b. The process for selecting reinsurance partners;

    c. The process of establishing the type and level of reinsurance required; and

    d. The amount of and the methodology used to calculate the maximum loss per risk and per event.

50. Provide details of the process for:

a. Ensuring continuing appropriateness of the reinsurance strategy;

b. Implementation of this strategy; and

c. Monitoring and oversight of this strategy.

51. Describe the impact of the reinsurance strategy on the overall capital requirements; including details on reinsurance treaties where cancellation of the treaty would lead to an increase in the Prescribed Capital Target (PCT) of more than 15%.

52. Discuss the factors taken onto account in determining the net retention per risk and the retention on the company quota share programmes.

53. Comment on the use of facultative reinsurance by the insurer with reference to how and why the decision to purchase facultative reinsurance is made.

54. Provide the following with regard to catastrophe cover:

a. The level of catastrophe cover purchased;

b. The decision process for selecting this amount of cover; and

c. The number of reinstatements for catastrophe cover and their sufficiency.

d. The methodology used to calculate the Maximum Event Retention

55. The report must highlight changes to the reinsurance strategy over the prior reporting period, with specific reference to:

a. The type of reinsurance cover purchased;

b. The net retention levels;

c. The amount of catastrophe cover purchased; and

d. The lead reinsurer on major contracts.

56. Outline the maximum unprotected net retention per risk by class of business.

57. Provide the following peak exposure information for the five largest risks in respect of Property, Transportation, Guarantee, Liability Engineering and Miscellaneous business classes:

a. A brief description of the risk

b. Total sum insured

c. Estimated maximum loss (EML)

d. Annual premium charged on the risk

e. Percentage facultatively insured

f. Lead insurer

g. Percentage participation

58. Comment on how total exposure per reinsurer is monitored.

59. Provide the following information on the monitoring of reinsurer exposure:

a. Details of assistance provided by reinsurance brokers in placing the reinsurance programme; and

b. Details of any caps on the total exposure that can be ceded to any one reinsurer.

60. Provide details of any reinsurance contracts that contain any one of the following provisions:

a. Limitation on the payment of claims when the primary insurer is in financial difficulty (curatorship or liquidation); and

b. Unilateral reduction in cover.

61. Provide details of any:

a. Alternative Risk Transfer (ART) kinds of treaties entered into (e.g. securitization, financial reinsurance, committed capital);

b. Whole account protections e.g. stop loss or spread loss arrangements; and

c. Business where 100% of the risk is ceded to a third party; including an explanation of the strategy with regards to this business and amount of business written in the previous financial year.

4.6. Group Risk

62. Outline significant developments in companies within any broader Group of companies with which you are affiliated, which may impact on your business. This includes but is not limited to related holding companies, investment companies and subsidiaries. How do you identify Group risk, and how do you manage it?

5. Customers, Markets and Products

63. Provide an outline of the products that you offer, and any significant new products introduced over the last twelve months.

64. If there are any ‘loss leaders’ mention them and how exposure to these will be limited in future.

65. Describe your historic and current customer base, and your target market.

66. Discuss your approach to ensuring that your products are appropriate to your market.

67. Discuss the effectiveness of your complaints management system and how this is measured.

68. Describe your philosophy and practice vis-à-vis treating your customers fairly. This includes matters of disclosure, product design and marketing.

6. Supplementary Documents

69. The following documents must be provided with the FCR report:

a. Risk management strategy signed by the Board

b. Investment policy

c. Derivative investment policy

d. Reinsurance strategy document signed by the Board