Module D Unit 6A

THE REGULATORY ENVIRONMENT

Purpose

There are over 1800 pages of applicable laws, regulation, codes, rules, instructions and guidance on the GFSC website. It is not expected that the participant will have read or know all of these but rather that there is an awareness of their existence and any understanding as to how to access, interrogate and apply them.

Assumed knowledge

None but please refer to the link below for a list of applicable laws, regulations, rules, codes and guidance on the GFSC website

https://www.gfsc.gg/industry-sectors/insurance/legislation-and-guidance

Summary of learning outcomes
1. Explain where to find all laws, regulations, rules, codes and guidance and how to interrogate the contents.
2. Explain the requirements of the Cyber Security Rules and breach notifications.
3. Explain the conflicts of interest inherent in PORCs and POICs and how they should be addressed.
4. Understand what constitutes a change of business plan that needs to be advised to the GFSC
5. Describe the circumstances around a change of shareholder that should be advised to the GFSC.

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6.0 INTRODUCTION

At the heart of the regulatory environment in Guernsey is the Insurance Business (Bailiwick of Guernsey) Law, 2002 ("the Law") which is the subject of a specific Module. This Module is concerned with the Rules, Regulations, Codes and Guidance that complement the Law.

Of course, there is a wider governance environment than just regulatory as all insurers (apart from branches) are companies, or part of a cell company, and are therefore subject to the requirements of the Companies (Guernsey) Law 2008. Insurers are also subject to the Principles of Conduct of Finance Business and the directors are subject to the Code of Practice – Company Directors. However, the Companies Law, the Principles and this Code of Practice apply to all firms and/or directors, and not just to those concerned with insurance companies. As a result, they fall outside of the scope of this Module.

6.1 GUERNSEY FINANCIAL SERVICES COMMISSION ("GFSC")

The GFSC is the regulatory body for the finance industry in the Bailiwick of Guernsey. As stated on its website www.gfsc.gg it "seeks to secure good regulatory outcomes with integrity, proportionality and professional excellence, thereby generating confidence in the Bailiwick as a jurisdiction".

It is an independent public body, funded entirely by the licensees that it regulates, by means of annual fees. It is accountable to the States of Guernsey which is responsible for the Bailiwick's financial services industry and for establishing the regulatory regime.

The GFSC supervises and regulates over 2,000 licensees within the banking, fiduciary, insurance and investment sectors. It does that in accordance with standards set by international supervisory bodies such as the International Association of Insurance Supervisors.

The GFSC uses use a risk based approach to the supervision of licensees which is underpinned by a system known as PRISM (Probability Risk and Impact SysteM). It is a structured system which enables the GFSC to focus its finite supervisory resources on high value, forward-looking, supervisory activity with a strong emphasis on the business models and governance of the most significant licensees in the Bailiwick. It requires the GFSC's staff to challenge, to make judgements and to mitigate unacceptable risks – prudential, financial crime or conduct-related. PRISM helps the GFSC ensure that it anticipates and addresses problems before they become crises. However, it is accepted that it is not a panacea and there will still be licensee failures.

The following covers the most frequently referenced Rules, Regulations, Codes and Guidance within the regulatory environment but is not an exhaustive list and additions and/or amendments are made from time to time. Please visit the GFSC website to see all currently applicable. There are over 1,800 pages so it is not expected that you will learn all from this course material but you should make yourself familiar with where is can be found and seek to extend your knowledge and understanding of it overtime.

https://www.gfsc.gg/industry-sectors/insurance/legislation-and-guidance

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Rules

6.2 THE INSURANCE BUSINESS RULES AND GUIDANCE, 2021. SEE APPENDIX 6A

6.2.1 Conduct of Business

These Rules are based on Insurer Core Principle 19 - Conduct of Business ("ICP 19") which was adopted by the International Association of Insurance Supervisors (of which Guernsey is a member) in November 2017. ICP 19 requires that insurers, in their conduct of insurance business, treat customers fairly, both before a contract is entered into and through to the point at which all obligations under a contract have been satisfied.

The Rules apply to all Category 1 (Commercial Life) and Category 3 (Commercial General) licensed insurers, as categorised under the Insurance Business (Solvency) Rules and Guidance, 2021, writing business with retail customers.

The Rules place requirements on those insurers in scope in relation to the following areas of business conduct:

- Due skill, care and diligence when dealing with customers;
- Fair treatment of customers;
- Conflicts of interest;
- Dealing with intermediaries to ensure the fair treatment of customers;
- Development and distribution of insurance products;
- Promotion of products and services;
- Provision of timely, clear, and adequate pre-contractual and contractual information to customers;
- Servicing and disclosure in relation to policies
- Timely, fair, and transparent claims handling; and
- Timely and fair manner complaints handling.

6.2.2. Public Disclosure of Information

Public disclosure is a well-established pillar of international regulatory standards and Insurance Core Principle 20 ("ICP 20") prescribes the standards expected within an insurance framework. ICP 20 requires the disclosure by insurers of relevant information to give both policyholders and other market participants a clear view of insurers' business activities, performance and financial position. Such disclosure is intended to enhance market discipline and the understanding of risk and risk management.

These Rules apply to all licensed insurers, with the exception of all Category 5 (Captives) and Category 6 (Special Purpose Entities) insurers, all Protected Cell Companies and non-Bailiwick incorporated entities.

The Rules require relevant insurers to make audited financial statements available to policy holders, professional advisers and to others with a valid interest. In addition, relevant insurers are obliged to publish on line their audited financial statements and certain additional information unless they fit into one or more of the following categories:

- the insurer has annual gross written premium income not exceeding £500,000, or gross assets not exceeding £2.5 million; providing that, if the insurer is in run off (by which it is no longer taking on new business but still has outstanding liabilities to existing policyholders), it would have met these conditions in its last full year of underwriting.

- the insurer has reinsured 75% or more of its insurance risk with a group insurer;
- the insurer writes reinsurance for related group insurers only;
- the insurer writes a single class of reinsurance for one fronting insurer in relation to a specific product or arrangement; or
- the insurer has a small number of commercial policyholders only.

All or any part of this disclosure may be withheld, redacted or summarised where disclosure would enable competitors of the insurer to gain undue advantage or otherwise cause detriment to the insurer, or where the information is confidential in nature or where disclosure may breach laws or regulation.

The additional information is as follows:

- **Profile of the insurer -** including the nature of its business, a general description of its key products, the external environment in which it operates and information on its objectives and the strategies in place to achieve them.
- **Corporate governance -** including the key features of the *licensed insurer's* corporate governance framework, management controls and risk management framework.
- **Technical reserves - d**etailed quantitative and qualitative information about the determination of technical provisions.
- **Insurance risk -** quantitative and qualitative information on all reasonably foreseeable and relevant material insurance risk exposures and their management.
- **Financial performance -** quantitative and qualitative information on financial performance in total and by segmented financial performance.
- **Capital adequacy -** appropriately detailed quantitative and qualitative information about capital adequacy.
- **Financial instruments -** quantitative and qualitative information about financial instruments and other investments by class.
- **ERM and ALM** - quantitative and qualitative information about enterprise risk management ("ERM") including asset-liability management ("ALM").

6.2.3 Duties of General Representatives

A general representative of a licensed insurer must –

(a) act as the principal point of contact within the Bailiwick for all communications with the Commission;
(b) be responsible, on behalf of the licensed insurer, for filing the licensed insurer's annual return and business plan;
(c) be responsible for monitoring and reporting to the Commission on the licensed insurer's compliance with:

(i) the business plan filed;
(ii) any conditions or directions issued by the Commission;
(iii) Part 7 (Conduct of Business), where appropriate, and any other relevant legislation, Code of Conduct or Code of Practice;
(iv) The AML and CFT Handbook and any other anti-money laundering procedures and guidelines imposed by the Bailiwick; and
(v) solvency requirements imposed by law or the Commission;

(d) where appropriate, provide a money laundering reporting officer, resident in the Bailiwick, on behalf of the licensed insurer;

(e) where appropriate, provide a money laundering compliance officer, resident in the Bailiwick, on behalf of the licensed insurer;
(f) ensure that adequate books and records, in relation to the business of the licensed insurer carried out through its place of business in the Bailiwick, are maintained in the Bailiwick and available for inspection by the Commission;
(g) be responsible for marketing literature and advertisements issued in or from within, the Bailiwick by that licensed insurer; and
(h) be responsible for maintaining a register of any complaint made against the licensed insurer, in respect of business conducted in the Bailiwick, acting as the initial point of contact and address for such complaints.

6.3 THE CYBER SECURITY RULES AND GUIDANCE, 2021

Technology risks including information security, cyber security and data privacy are all key considerations for insurers regulated by the GFSC and should be considered by other interested parties.

As with other material risks, all licensed institutions are required by the GFSC to have robust policies, procedures and controls in place to identify, assess and manage cyber security risks on an on-going basis consistent with the minimum licensing requirements.
These Rules focus on five core principles outlined in a number of international cyber security frameworks–

- Identify, Protect, Detect, Respond and Recover.

The GFSC recognises that there is no “one size fits all” approach to addressing cyber risks with specific business circumstances varying greatly from insurer to insurer. It may be appropriate for insurers to consider accreditation or certification from a recognised body, such as Cyber Essentials1, Cyber Essentials Plus or ISO270001. These accreditations may help aan insurer in meeting some of the requirements set out in the Rules, however, accreditation alone is unlikely to result in full compliance.
The following guidance provides boards with examples of how an insurer may satisfy the requirements laid out in the Rules. Not all of the examples outlined in the guidance will be relevant to all insurers and it remains the responsibility of the board to ensure that the insurer complies with the Rules.

Insurers that outsource large portions of their operation are still expected to comply with the Rules, however it may be reasonable for the board of such an entity to expect the outsourced provider to complete much of the control framework outlined in the Rules and this guidance. The board would, nonetheless, be expected to have oversight of these services and would be responsible for compliance with these Rules.

6.3.1 Application and operation

(1) The Rules have direct application to all insurers.

(2) The board of the insurer is responsible for ensuring that the Rules are followed.

(3) All insurers must be able to provide evidence, to the GFSC on request, that these Rules have been considered and implemented in accordance with the size, nature and complexity of the insurer’s business.

(4) The insurer must, taking into consideration the size, nature and complexity of its business, have in place appropriate policies, procedures and controls to mitigate the risk posed by cyber security events. Any policies, procedures and controls adopted, by the insurer, must reflect these Rules and take into consideration any guidance issued by the GFSC.

(5) All relevant measures adopted, by the insurer in order to comply with these Rules, must be reviewed –

(a) in response to a trigger event;
(b) following an identified cyber security event; or
(c) at least periodically

and must be recorded by the insurer.

(6) The GFSC may in its absolute discretion, by written notice to an insurer, exclude or modify the application of any provision of these Rules if the insurer satisfies the GFSC that such a derogation does not prejudice the interests of the clients of the insurer or the reputation of the Bailiwick.

6.3.2 Risk Assessment of Cyber Vulnerabilities and Risk - Identify

(1) The insurer must ensure that it has taken appropriate steps to identify all of its material assets and carried out an assessment of significant associated cyber risks.

6.3.3 Protecting IT Services

(1) The insurer must ensure that it has the appropriate policies and controls in place to mitigate the risks it has identified and to ensure, where possible, the delivery of critical infrastructure during and following a cyber security event. These policies and controls should include but are not limited to –

(a) having appropriate cyber security software in place;

(b) ensuring that IT system updates, from infrastructure and software providers, are implemented in a timely manner;

(c) the provision of employee training to enable the recognition of possible cyber security events;

(d) having policies in place to ensure that all users are aware of their impact on cyber security.

6.3.4 Detecting Cyber Security events

(1) The insurer must have appropriate mechanisms in place in order to identify the occurrence of a cyber security event.

6.3.5 Recovery from a Cyber Security event

(1) The insurer must be able to demonstrate that it is aware of the appropriate steps that need to be taken in order to restore business capabilities, following a cyber security event, and ensure essential activities are capable of being undertaken in the interim period.

6.3.6 Responding to Cyber Security events

(1) The insurer must be able to demonstrate that it has a plan in place which aims to mitigate any disruption caused by a cyber security event.

(2) Where the insurer is part of a group and the maintenance and recovery of IT systems is controlled at group level; the insurer must be able to demonstrate that it is aware of any group plan specific to the systems it uses and that the plan is appropriate to the licensee.
(3) Where the maintenance and recovery of the insurer's IT systems are outsourced to a third party provider it must ensure that it is aware of any plan which has been put in place, by that provider, and that the plan is appropriate to the insurer.

6.3.7 Notification to the GFSC

(1) An insurer must notify the GFSC, as soon as reasonably practicable, upon becoming aware of a cyber security event which has resulted in –

(a) any loss of significant user data;

(b) significant loss of availability to IT systems;

(c) significant cost to the business;

(d) significant loss of business capability;

(e) significant loss of service to users.

(2) The notification must include the following details pertaining to the cyber security event –

(a) date on which it was discovered;

(b) date on which it occurred;

(c) its nature;

(d) current resulting consequences;

(e) any possible future consequences;

(f) actions taken to mitigate the consequences;

(g) any further steps to be taken.

6.4 REGULATIONS

6.4.1 The Insurance Business Rules and Guidance 2021

These can be found in the appendices 6A

6.5 CODES

6.5.1 Code of Corporate Governance

This is covered in detail in Unit 16A – Governance.

6.5.2 Guidance Note for Licensed Insurers on Reinsurance and Other Forms of Risk Transfer

This Guidance, consistent with ICP 13, Reinsurance and Other Forms of Risk Transfer, clarifies expectations around the use of reinsurance. This guidance addresses the need for a reinsurance programme to form part of the wider risk management framework and to be appropriately controlled and governed.

The Guidance sets out what the GFSC expects as follows:

- A ceding insurer should have a reinsurance programme that is appropriate to its business, and that is part of its wider underwriting, risk and capital management strategies.
- An insurer should establish effective internal controls over the implementation of its reinsurance programme.
- An insurer should consider the impact of its reinsurance programme in its liquidity management.

6.6 GUIDANCE NOTE ON PRODUCER OWNED (RE)INSURANCE COMPANIES

Producer Owned Reinsurance Companies ("PORCs") are companies, or cells of protected or incorporated cell companies, that are beneficially owned by the producers (eg intermediaries or introducers) of insurance business where such insurance business is ultimately reinsured into the PORC through a fronting insurer. There are additional risks associated with these reinsurance vehicles since the producer could be in a position to influence the placing of business with its own PORC and could control the level of premiums or commissions that apply.

A Producer Owned Insurance Company ("POIC") is similar, although there is no independent fronting insurer, and therefore raises the same regulatory issues.

6.7 THE ISSUES

A client buying insurance cover where a PORC or POIC structure is present can be recommended by the producer to purchase a particular policy because it will generate an underwriting profit for the producer's company and not because it is the most suitable policy for the client. The producer could also cherry pick the best risks for its own PORC and offload the poorer risks to other carriers. They have also been used in fraudulent schemes where the PORC structure has been deliberately misused.

6.8 DEALING WITH CONFLICTS IN PORCS AND POICS

6.8.1 PORCs

PORC applicants and managers should identify and manage all the potential conflicts of interest faced by the producer and other related parties in the proposed structure. The GFSC will expect to see evidence that the applicant and managers have considered the conflicts and dealt with them accordingly. This may include providing detailed information to policyholders about the structure and its financial benefits for producers so that they can give their fully informed consent to the use of such vehicles and/or generating a greater amount of supporting evidence to demonstrate that clients are being treated fairly.
In common with all applications the GFSC will consider matters such as underwriting policies and controls, the level of commissions paid to the producer and whether this exceeds any potential loss, and if required,

whether additional capital is available. Of particular relevance will be whether the producer is itself regulated.

6.8.2 POICs

In principle the issues involved in consideration of POIC applications will be the same as for PORCs. Depending on the structure and location of the producer, the GFSC may require additional controls or disclosure be put in place to ensure transparency and fairness is maintained for policyholders in the same way as for PORCs above***.***

6.9 GUIDANCE NOTE ON NOTIFICATIONS TO THE COMMISSION

For certain matters the Law stipulates that the specific approval of the GFSC is required. The GFSC has issued a guidance note for other matters, as follows:

6.10 CHANGE OF AUDITOR

Section 34 of the Law imposes certain requirements on licensed insurers in relation to the appointment of an auditor. The GFSC's approval is not required and the GFSC does not routinely acknowledge notification of the resignation of an auditor, or the appointment of a new auditor. Licensed insurers should take steps to ensure that they comply with the requirements of the Law.

6.11 CHANGE OF YEAR END

A change of year end does not require approval but should simply be notified to the GFSC in order that it can amend its records and know when to expect the annual return. Licensees should ensure that they comply with Company Law requirements in relation to changes to financial periods. The GFSC does not acknowledge the notification of a change of year end unless it raises specific questions on which further information is required.

6.12 PAYMENT OF DIVIDENDS

Unless a specific condition has been imposed on an insurer's licence the declaration of or payment of a dividend does not require either notification to, or the approval of, the GFSC. Such notifications will not be acknowledged. Licensees must ensure that they do not declare dividends in breach of section 31 of the Law.

6.13 CHANGE OF BUSINESS PLAN

The Law requires that a material change of business plan should be notified to the GFSC prior to the implementation thereof. There is no need for an insurer, having notified the GFSC of a material change to its business plan, to wait for the GFSC approval of that plan. The GFSC does not routinely acknowledge a change of business plan. If, having considered the notification, the GFSC requires further information it will request it; recognising that the change may already have been implemented. If a licensee is in any doubt regarding a change of business plan it should call the GFSC to receive verbal guidance on whether a notification should be submitted.

6.14 GENERAL INSURERS

The GFSC has provided guidance as to what the Commission regards as a material change of business plan. It is not exhaustive but is intended to illustrate the nature of changes for which the GFSC would expect to receive notification.

- Captive insurers – a material change of business plan for a captive insurer would be starting to write unrelated party business, or, business that requires a long-term insurance licence. It is anticipated that, given this guidance, a captive insurer will rarely need to notify a material change of business plan and will simply file a business plan annually with its annual return.

- Commercial insurers writing business to unrelated parties – any new line of business to be written; any change to reinsurance arrangements which reduces the reinsurance protection; any change of business plan which reduces the solvency margin to less than125% of the required margin.

- Commercial Reinsurers – any new line of business which represents an increase in premium of 30%; any change of business plan which reduces the solvency margin to less than 125% of the required margin.

Guidance on the content of narrative business plans is set out in the guidance note and any notification should always include a completed spreadsheet business plan which can be found on the GFSC's website together with a guidance note on its completion.

6.15 LONG-TERM INSURERS

A material change of business plan for a life insurer would include: a new product; a new source of business; a change in the geographical sources of business; a change in the policyholder protection arrangements (but see below regarding custodians)
A material change of business plan for a life reinsurer would include: a new line of business or a new transaction which increases policyholder liabilities by 30% or more.

6.16 APPOINTMENT OF CUSTODIAN

The standard condition applying to long-term insurers requires the insurer to appoint a trustee which must be approved by the GFSC. However, the appointment of custodians is not required to be approved by the GFSC and the standard condition simply requires the insurer to notify the GFSC in its business plan of the custodians it intends to use. The insurer is responsible for ensuring that the custodians are independent of the insurer and the insurance manager. The GFSC does not routinely acknowledge notifications of custodian appointments.

6.17 ALTERNATE DIRECTORS

Where a member of staff of an insurance manager, who has already filed a personal questionnaire and received approval to act as a director/alternate director, wishes to act as an alternate director for a one off

client board meeting he\she may do so without the prior approval of the GFSC. A Personal Declaration to that effect should subsequently be filed with the GFSC's Authorisations Unit.
For the avoidance of doubt, the appointment of a permanent alternate director does still require the prior approval of the GFSC.

6.18 PQ REQUIREMENTS FOR CELLS OF A LICENSED PCC

The GFSC only requires a completed Personal Questionnaire ("PQ") for any individual who, alone or with associates, beneficially owns 50% or more of the cell shares issued in respect of any cell. Individuals who may have general oversight of a cell from the parent company perspective or whom the insurance manager deems to be the day to day controller of the cell are not required to submit a PQ. Insurance managers should continue to carry out their own due diligence on their client and relevant individuals as necessary to fulfil their obligations under the Handbook.

6.19 NOTIFICATION OF ACQUISITION OF SIGNIFICANT SHAREHOLDING

Licensees that are companies are required to make a notification, under section 49 of the Law, of the acquisition of between 5% and 15% of the voting power of the licensee. Such notifications are not routinely acknowledged unless queries arise on which further information is required by the GFSC (Note: this requirement does not apply to cells).

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Self-test questions
Answering these questions will remind the participant as to what has been learnt. Once completed, please check your answers against the relevant text. 1. Why is it so important to know where to access the regulatory regime applying to a Guernsey insurer? 2. What are the five core principles of the Cyber Security Rules? 3. What is are PORC’s and POIC’s and why are they of concern to the GFSC? 4. What are the keys differences between the regulation of a captive and a commercial insurer? Why is this so important to the reputation of Guernsey? (Unit 24 will be useful in this regard.)

Summary of learning outcomes
1. Explain where to find all laws, regulations, rules, codes and guidance and how to interrogate the contents.
2. Explain the requirements of the Cyber Security Rules and breach notifications.
3. Explain the conflicts of interest inherent in PORCs and POICs and how they should be addressed.
4. Understand what constitutes a change of business plan that needs to be advised to the GFSC
5. Describe the circumstances around a change of shareholder that should be advised to the GFSC.