



**ISLE OF MAN  
FINANCIAL SERVICES AUTHORITY**

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**CONSULTATION PAPER**

**CP19-04/T04**

**CLASS 12 INSURANCE AUTHORISATION**

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**This consultation paper is issued by the Isle of Man Financial Services Authority (“the Authority”), the regulatory authority responsible for the supervision of the financial services, insurance and pensions sectors in the Isle of Man.**

### **What is this paper for?**

In June 2013 Authority published its Roadmap for updating the Isle of Man’s regulatory framework for insurance business (“the Roadmap”). That document set out the objective to establish a project to implement a framework for the regulation and supervision of insurers, insurance managers and general insurance intermediaries that would establish a high level of observance in respect of the updated and revised Insurance Core Principles (“ICPs”) issued by the International Association of Insurance Supervisors (“IAIS”), and remain appropriate and proportionate to the risks of the different parts of the insurance industry that operates in and from the Isle of Man.

This continues to be the objective of the Authority.

Since 2013 the Roadmap has been updated annually and more recently every six months to reflect progress made.

This paper deals with an element of the framework for the regulation and supervision of insurers by setting out proposed criteria whereby an insurer may qualify for class 12 authorisation.

Insurers authorised as class 12 will be subject to a reduced level of regulation.

### **Who is affected by this paper?**

This paper will be of interest to the boards and senior management of existing and prospective insurance companies in the Isle of Man, as well as policyholders and other insurance market participants.

### **How may I respond to this paper?**

The closing date for comments is 13 September 2019. Please send comments by email to

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## Contents

Glossary of Terms.....	5
1. Introduction and background .....	6
2. Attachment and its context in wider developments .....	6
3. Executive Summary .....	7
4. Questions and additional comments in relation to the draft regulations .....	8

## Glossary of Terms

Term	Meaning in this paper
<b>Act</b>	Insurance Act 2008
<b>Authority</b>	The Isle of Man Financial Services Authority
<b>Captive</b>	In general terms is an insurer which insures the group to which it belongs
<b>Class 12</b>	A class of authorisation under section 8 of the Act which applies a reduced level of regulation
<b>Commercially fronted</b>	Reinsurance where an underlying (re)insurer provides cover which is subject to a full level of regulation
<b>IAIS</b>	International Association of Insurance Supervisors
<b>ICPs</b>	Insurance Core Principles (of the IAIS)
<b>Insurer</b>	Insurer authorised under section 8 of the Act
<b>Island</b>	The Isle of Man
<b>PCC cell</b>	A cell of a protected cell company
<b>Producer owned</b>	In general terms is a reinsurer beneficially owned by the producers (intermediaries or introducers) of the insurance business it reinsures
<b>Reinsurer</b>	Insurer authorised under section 8 of the Act in respect of reinsurance business
<b>(Re)insurer</b>	Insurer and/or reinsurer as the context requires, and similar applies for <b>(re)insurance</b> and <b>(re)insured</b>
<b>Roadmap</b>	Roadmap for updating the Isle of Man’s regulatory framework for insurance business

## 1. Introduction and background

- (1) The IAIS's ICPs are an international standard for insurance supervision.
- (2) A theme of the ICPs is that supervisory frameworks should be proportionate to the nature, scale and complexity of the risks posed by insurers and of risks to which insurers may be exposed.
- (3) The Authority supports a proportionate approach to regulation.
- (4) This paper seeks to identify certain types of insurer which pose lower risk to policyholders and therefore may be subject to a reduced level of regulation. Those insurers would be able to apply for class 12 authorisation for that purpose.
- (5) The Authority has engaged in prior discussions with the Isle of Man Captive Association in relation to the proposals contained in this paper. The Authority has sought, where appropriate, to take account of industry feedback provided to date.

## 2. Attachment and its context in wider developments

- (6) Attached are the proposed regulations in respect of the qualifying criteria for class 12 authorisation.
- (7) The proposed regulations will, in due course, form part of a wider update to the Insurance Regulations 2018 anticipated to be consulted on later this year.
- (8) Preparation of the proposed regulations has been accelerated as a priority in order to facilitate finalisation of other regulatory workstreams such as capital and solvency, and corporate governance, which will have regard to providing proportionately reduced requirements in relation to class 12 insurers.

### 3. Executive Summary

- (9) In the attached regulations reduced regulatory requirements under class 12 authorisation are proposed to be applied to the following types of (re)insurers, or combination thereof:
- (a) (Re)insurers where policyholders (or direct policyholders underlying reinsurance) are directly or indirectly related to the (re)insurer.
  - (b) (Re)insurers where policyholders (or direct policyholders underlying reinsurance) are sophisticated parties that have consented on an informed basis to being (re)insured by a class 12 (re)insurer.
  - (c) Commercially fronted reinsurers.
  - (d) Other reinsurers where the underlying direct insurance is ancillary to a main non-insurance activity of the reinsurer's group.
  - (e) A class 12 (re)insurer whose non-class 12 insurance business represents less than 5% of its total business (the "de-minimis rule").
- (10) However, individuals within the categories set out in paragraph (9) may only be (re)insured in the following circumstances:
- (i) In respect of paragraph (9)(a) (assuming that the business does not already qualify as class 12 under any of paragraphs (ii) to (iv) below) individuals who are—
    - employees (and their relatives) of related legal entities where the (re)insurance is an employee benefit; and
    - directors or officers of related legal entities where the (re)insurance is linked to those roles.
  - (ii) In respect of paragraph (9)(b), any individual may be (re)insured if the individual is suitably sophisticated and provides informed consent.
  - (iii) In respect of paragraph (9)(c) and (9)(d), any individuals may be insured by way of the direct insurance underlying the reinsurance.
  - (iv) In respect of paragraph (9)(e), any individuals may be (re)insured.

That Authority considers that in respect of employees (and their relatives) insured under an employee benefit (per 10(i) above), a form of mandatory regulatory disclosure of the insurer's Class 12 reduced regulatory requirement may be appropriate. The Authority will formalise its views in this area as part of its consideration responses to this consultation.

- (11) This paper asks readers for any views they wish to communicate to the Authority on these proposals.

## 4. Questions and additional comments in relation to the draft regulations

Unless indicated otherwise, references to paragraphs in the following are references to paragraphs in the attached regulations.

- (12) (Re)insurance in relation to related parties: paragraphs 3(1)(a)(i) and 3(1)(b)(i) and paragraphs 1 and 2 of Schedule 1.

The general rationale for applying class 12 authorisation to (re)insurers where policyholders (or direct policyholders underlying reinsurance) are related parties of the (re)insurer is that any additional risks the class 12 (re)insurer may pose to those policyholders due to its reduced regulatory requirements is ultimately a risk to members of the group to which the class 12 (re)insurer belongs, and not third parties.

Also, as the class 12 (re)insurer and the policyholders are members of the same group, they have significant interests in common and therefore there is an increased likelihood (when compared with third party business) that the group will financially support the class 12 (re)insurer if needed.

### Questions:

- A. The Authority welcomes views on the above mentioned rationale as a basis for applying a reduced level of regulation.
- B. Do readers agree or disagree with any element of the draft regulations in paragraphs 3(1)(a)(i) and 3(1)(b)(i), and paragraphs 1 and 2 of Schedule 1, concerning the class 12 qualifying criteria applicable to the (re)insurance of related parties?
- C. For example, such elements of the draft regulations include the—
  - a. 45% threshold in relation to the qualifying criteria of shareholder voting rights, or share holdings in relation to a PCC cell (and the position that collective qualifying rights/holdings must be via a joint venture agreement);
  - b. the qualifying criterion of the right to appoint or remove the majority of a relevant board of directors (and the position that this does not apply to a mutual or to PCC cells);
  - c. permission for an insurer that is a mutual to insure its mutual members (and the requirement for such a mutual to be able to make adequate calls on its members, where needed, to top up its capital to meet its regulatory capital requirements); and

d. permission for an insurer to directly insure employees, directors and officers of its legal entity related parties (or the limited circumstances that apply, i.e. limited to benefits for employees, or linked to the roles of directors and officers).

D. In relation to C.d. above, do readers agree with the Authority's initial view that any direct insurance of such parties should include a mandatory requirement to disclosure of the nature any class 12 insurer involved?

*In responding to specific questions or providing other feedback in relation to this paper, readers are requested to provide the rationale for any views expressed or any changes suggested.*

(13) **Insurance in relation to sophisticated, informed and consenting parties: paragraphs 3(1)(a)(ii) and 3(1)(b)(i) and paragraph 3 of Schedule 1.**

The principle behind informed consent is that, where a prospective policyholder does not otherwise qualify as a person that can be insured by a class 12 (re)insurer, the prospective policyholder can still qualify by actively accepting the potential risks involved.

The general rationale for applying class 12 to (re)insurers of sophisticated, informed and consenting parties (whether as a policyholder or direct policyholders underlying reinsurance) is that this type of policyholder is less vulnerable when compared, for example, to members of the general public or unalerted parties.

In other words, an informed sophisticated party can be expected to have, or readily have access to, the expertise, resources and impetus necessary to understand and manage the potential risks associated with entering into an insurance contract with an insurer that is subject to reduced regulation. This is opposed to, for example, a member of the general public who cannot ordinarily be expected to have such expertise or resources; or a sophisticated third party that has not been alerted to the potential risks involved.

**Questions:**

E. The Authority welcomes views on the above mentioned rationale as a basis for applying a reduced level of regulation.

F. Do readers agree or disagree with any element of the draft regulations in paragraphs 3(1)(a)(ii) and 3(1)(b)(i), and paragraph 3 of Schedule 1,

concerning the class 12 qualifying criteria applicable to the (re)insurance of sophisticated, informed and consenting parties?

- G. For example, such elements of the draft regulations include the—
- a. requirement that only direct policyholders (and not fronting insurers or other ceding reinsurers) are eligible to give informed consent (any implied informed consent in relation to insurance counterparties is implied in the provisions applying class 12 authorisation to reinsurance business – see points (14), (15) and (16) of this paper);
  - b. choice of a principles-based approach (rather than rules-based approach) in the provisions of paragraphs 3(1)(a) and 3(2)(a) of Schedule 1;
  - c. content of paragraphs 3(1)(a) and 3(2)(a) of Schedule 1;
  - d. requirements under paragraph 3(1)(b) of Schedule 1 that, prior to a contracts being entered into—
    - i. a prospective consenting party must be alerted the potential risks involved;
    - ii. informed consent must be given; and
  - e. requirements under paragraph 3(2) of Schedule 1 for insurers to obtain and hold evidence of informed consent’ (including assessing the prospective consenting party against the qualifying criteria in paragraph 3(1)(a) of Schedule 1).

*In responding to specific questions or providing other feedback in relation to this paper, readers are requested to provide the rationale for any views expressed or any changes suggested.*

(14) **Commercially fronted reinsurance: paragraph 3(1)(b)(ii).**

The Island does not have a sizeable reinsurance sector where the underlying business is open-market/retail insurance provided to third parties. In that context the default regulatory position proposed, subject to certain regulatory discretion (see the following paragraph below), is to apply class 12 to commercially fronted reinsurers. This will, for example, provide a degree of simplification for some ‘captive’ and ‘producer owned’ style reinsurers to monitor and maintain their class 12 status. It will also provide scope for other businesses, which may not fully meet the qualifying criteria for class 12 on a direct writing basis, but may still merit class 12 authorisation due to the reduced risk to underlying policyholders inherent in providing reinsurance where commercially fronted.

However, to accommodate any change or growth in the Island's commercial reinsurance sector, the Authority would reserve a discretionary power to determine that a reinsurer should be subject to a full level of regulation (see point (16) in this paper).

Given the default position, the main rationale in support of applying class 12 to commercially fronted reinsurance is that reliance can be placed on the fronting insurer (or a reinsurer lying between the fronting insurer and the class 12 reinsurer) to provide a suitable degree of protection in relation to underlying policyholders irrespective of the class 12 reinsurer's involvement.

**Questions:**

- H. The Authority welcomes views on the above mentioned rationale as a basis for applying a reduced level of regulation.
- I. Do readers agree or disagree with any element of the draft regulations in paragraph 3(1)(b)(ii) and corresponding definitions in paragraph 4, concerning the class 12 qualifying criteria applicable to commercially fronted reinsurance?
- J. For example, such elements of the draft regulations include the—
  - a. reliance placed on a fronting insurer ("qualifying insurer") in paragraph 3(1)(b)(A);
  - b. reliance placed on any intermediate reinsurer ("qualifying reinsurer") between a fronting insurer and the class 12 insurer in paragraph 3(1)(b)(B); and
  - c. definition in paragraph 4 by which a qualifying insurer or reinsurer is determined

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- (15) **Other reinsurance ancillary to an activity of the insurer's group:** paragraph 3(1)(b)(iii) and Schedule 2.

This category applies to reinsurance which does not already qualify as commercially fronted business, as referred to in item (14) of this paper.

The principle behind this proposal is that a group which owns a reinsurer that provides reinsurance in respect of insurance cover that is ancillary to one of the group's main (non-insurance) activities is incentivised to make sure that the reinsurance remains reliable. The assumption being that, where a potential failure of the reinsurance could disrupt or otherwise reflect negatively on the group or its activity, the group would seek to avoid such impact and would be encouraged to financially support the reinsurer if need arose.

Accordingly, the general rationale for applying class 12 authorisation to providers of reinsurance that is ancillary to a main (non-insurance) activity of the reinsurer's group is to recognise the reduced risk of insolvency of the reinsurer.

(It should be noted that the Authority would reserve the power to determine that a reinsurer should be subject to a full level of regulation – see point (16) in this paper.)

**Questions:**

- K. The Authority welcomes views on the above mentioned rationale as a basis for applying a reduced level of regulation.
- L. Do readers agree or disagree with any element of the draft regulations in paragraph 3(1)(b)(iii) and Schedule 2 concerning the class 12 qualifying criteria applicable to reinsurance ancillary to an activity of the reinsurer's group?
- M. For example, such elements of the draft regulations include the—
  - a. application of the criteria to reinsurance and not direct insurance;
  - b. choice of a principles-based approach (rather than a rules-based approach) to the provisions of paragraph (1) of Schedule 2 (or the discretion given to the Authority in those provisions);
  - c. content of paragraph (1) of Schedule 2;
  - d. definition in paragraph (2) of Schedule 2 by which a reinsurer's group is determined.

*In responding to specific questions or providing other feedback in relation to this paper, readers are requested to provide the rationale for any views expressed or any changes suggested.*

(16) **Discretionary power to impose full level of regulation to reinsurer: paragraph 3(2)**

The Authority proposes to reserve the power to determine that a business which appears to be true open market reinsurance should be subject to a full level of regulation, as referred to in item 14 of this paper.

**Question:**

- N. Do readers agree, agree with some changes or disagree with the above mentioned discretionary power as a basis for disapplying a reduced level of regulation?

*In responding to specific questions or providing other feedback in relation to this paper, readers are requested to provide the rationale for any views expressed or any changes suggested*

(17) **The de-minimis rule: paragraph 3(3) and 3(4).**

The general rationale for allowing within class 12 authorisation an element of non-conforming business is to provide a degree of flexibility for a (re)insurer to accommodate incidental matters within its insurance programmes whilst preserving the reduced risk nature of the (re)insurer.

**Questions:**

- O. The Authority welcomes views on its proposed approach through the de-minimis rule.
- P. Do readers agree or disagree with any element of the draft regulations in paragraph 3(3) and 3(4) concerning the class 12 qualifying criteria applicable to a permission to write a small amount of business which is not class 12?
- Q. For example, such elements of the draft regulations include the—
- a. application of the de-minimis rule to technical provisions as they change over time under paragraph 3(4)(b) (it might be noted that the technical provision basis for calculating the de-minimis level is included because it is not susceptible to potential distortion due to premium rating or allocation, and, as referred to in item (18) below, because a reduced level of regulation should apply based on the current and not historic risk profile of the (re)insurer in question).

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- (18) **Application of class 12 requirements to prior years' business:** relevant to the de-minimis rule calculation in paragraph 3(4).

Further to in Question Q.a above, the class 12 qualifying criteria are intended to be applied to prior years' business based on the current profile of that business as reflected in the insurer's technical provisions. For example, if an insurance contract at time of contracting was with a policyholder that was a related party of the insurer, but because of subsequent group restructuring or divestment the policyholder no longer meets the criteria as a related party (or any other class 12 qualifying criteria), then the contract would no longer be considered as class 12 and the insurer's de-minimis calculation would change accordingly.

This approach is consistent with the basis of the Authority's previous quantitative impact studies (QIS) exercises which applied provisional new class 12 qualifying criteria to historical contracts by way of a 'decision tree'.

(It should be noted that a remedial mechanism, as referred to in item (20) of this paper, has been included to address any unintended non-compliance with the class 12 requirements, as changes in a (re)insurer's ongoing relationships with its policyholders (or direct policyholders underlying its reinsurance) may be outside of its control.)

**Question:**

- R. Do readers agree or disagree with the above mentioned approach as a basis for applying a reduced level of regulation?

*In responding to specific questions or providing other feedback in relation to this paper, readers are requested to provide the rationale for any views expressed or any changes suggested.*

(19) **General discretion in applying the class 12 qualifying criteria: paragraph 3(5).**

The Authority proposes to reserve the power to exercise regulatory discretion in respect of paragraphs 3(1) to 3(4) (including Schedules 1 and 2) in order to address any uncertainty in applying the requirements in practice.

**Question:**

- S. Do readers agree or disagree with the above mentioned discretionary power to address any uncertainty in applying the class 12 requirements?

*In responding to specific questions or providing other feedback in relation to this paper, readers are requested to provide the rationale for any views expressed or any changes suggested*

(20) **Remediation if class 12 requirements are not met: paragraph 5.**

As referred to in item (18) of this paper, a (re)insurer's business profile and relationships with other parties may change over time and this may impact its ongoing compliance position with the class 12 requirements. The draft regulations therefore include a remediation mechanism for any case where a class 12 (re)insurer experiences issues in complying with the class 12 requirements.

**Question:**

- T. Do readers agree or disagree with the inclusion of a remediation mechanism in relation to potential non-compliance with class 12 authorisation?

- U. Do readers agree or disagree with any element of the draft remediation mechanism in paragraph 5?

- V. For example, such elements of the draft regulations include the—
- a. specific requirement under paragraph 5(1)(a) to report any instance of non-compliance;
  - b. requirements under paragraph—
    - i. 5(1)(b) for the (re)insurer to submit a remedial plan and the timescales involved in doing so;
    - ii. 5(2) for the Authority's approval of any remedial plan;
    - iii. 5(3) for the (re)insurer to give effect to an accepted remedial plan;

- c. Authority's power under paragraph 5(4) to take steps to address any instance of failure to provide or execute a remedial plan, and the example matters under paragraph 5(5) it may take into account in doing so.

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(21) **Requirement to monitor compliance with class 12 requirements:** paragraph 6.

Specific ongoing compliance monitoring provisions have been included to help ensure that any potential issues may be identified in a timely manner and addressed using the above mentioned remediation mechanism.

**Question:**

- W. Do readers agree or disagree with the inclusion of a compliance monitoring requirement in relation to class 12 authorisation?
- X. Do readers agree or disagree with any element of the draft compliance monitoring requirement in paragraph 6?

*In responding to specific questions or providing other feedback in relation to this paper, readers are requested to provide the rationale for any views expressed or any changes suggested*