



ISLE OF MAN
FINANCIAL SERVICES AUTHORITY

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Consultation Response
Discretionary Civil Penalties for Entities
Regulated under the Insurance Act 2008

CR22-05

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Glossary

Authority	Isle of Man Financial Services Authority
Act	Insurance Act 2008
Serious regulatory failing	A serious contravention of the Act or any prohibition or requirement imposed under the Act
Authority	Isle of Man Financial Services Authority

1. Background

This Consultation Response is issued by the Isle of Man Financial Services Authority following Consultation Paper CP22-03¹.

The purpose of the consultation was to obtain views and evidence in relation to the making of regulations in respect of discretionary civil penalties for entities regulated under the Insurance Act 2008. The consultation is relevant to all authorised insurers, permit holders, registered insurance managers and registered insurance intermediaries.

2. Summary of Responses

The Authority received four responses from authorised long-term business insurers and one response from a registered insurance intermediary. No responses were received from authorised non long-term business insurers or registered insurance managers.

Responses from authorised long-term business insurers	
Insurer's response	Authority's response
<p>[The company] understands and is supportive of the rationale for the introduction of a framework for the calculation of Discretionary Civil Penalties. It is also supportive of splitting the Penalty into two levels reflecting the factors present in any given solution and the ability to reduce the Penalty where a Company has cooperated with the Authority and taken remedial action.</p>	<p>Thank you for your comments.</p>
<p>We note that within the definitions section of the Regulations the definition of "insurance contracts" and "investment contracts" have been switched around.</p>	<p>Thank you for your comments. This will be amended.</p>
<p>Overall the definition for Relevant Income feels appropriate and it aids transparency to base the calculation on audited figures within the financial statements. There are however some items that we would welcome further clarity over their treatment in the calculation of Relevant Income.</p>	
<ul style="list-style-type: none"> The Consultation paper appears to treat the deferral and recognition (amortisation) of income and 	<p>The consultation paper aimed to provide guidance on what would be classed as 'fee income' when determining an insurer's</p>

¹ <https://consult.gov.im/financial-services-authority/discretionary-civil-penalties/>

Responses from authorised long-term business insurers	
Insurer's response	Authority's response
<p>commissions in different ways. The amortisation of deferred income is treated as income whereas the consultation paper identifies commission paid as a deduction rather than the amount expensed to the Profit and Loss Account which would include the amortisation of deferred commissions. Is that treatment intentional or would the alignment of how the two are recognised in the Profit and Loss Account produce a more consistent result?</p> <ul style="list-style-type: none"> • We would welcome clarification as to whether commissions need to be explicitly labelled in the financial statements to qualify as deductible from income or whether their description as, for example acquisition costs deferred during the year in a note to the accounts would be acceptable? • An element of total income for life insurers can include certain fees collected on behalf of third party advisors which are subsequently paid onwards in full to such parties and incorporated within expenses. Can such third party income be excluded in the calculation of revenue, or alternatively can the cost be treated in the same way as commission as a deduction (particularly if separately identified and quantified with the notes of the company's financial statements?) 	<p>relevant income. This guidance was based on the various different formats of financial statements we receive from insurers (each of which uses different accounting practices) and was not intended to be exhaustive. Fee income for a particular insurer will reflect their accounting treatment of items such as deferred income and commissions.</p> <p>The definition of fee income will be amended to remove the guidance.</p> <p>A note in the accounts which clearly identifies commissions would be acceptable. However, if terms such as 'acquisition costs' or 'origination costs' were used then the note would have to be clear which costs solely relate to commission and not to other incentives or distribution related expenses.</p> <p>If an insurer determines it is appropriate to include 'third party' income within its fee income in its financial statements, then it is our view that it is also appropriate to include 'third party' income when determining relevant income.</p>
<p>[The Company] is supportive of the proposals as currently drafted, with one observation. The definition of relevant</p>	<p>Thank you for your comments.</p>

Responses from authorised long-term business insurers	
Insurer's response	Authority's response
<p>income for investment contracts looks reasonable, in that it represents the income accruing to the Insurer once commission has been paid. However, the definition of relevant income for insurance contracts appears to be slightly inconsistent with this, in that it ignores the fact that a proportion of the premium will be used to provide policyholder benefits. We believe that it would be appropriate to adjust the definition so that it represents the income that would be available to the Insurer.</p>	<p>We agree that the definition of relevant income for insurance products does not reflect the fact that a proportion of income received will be used to provide policyholder benefits.</p> <p>It is key that the definition of relevant income is transparent, and as such was designed so that the information can be taken direct from audited financial statements. Information regarding the proportion of income used to provide policyholder benefits is not traditionally available from audited financial statements.</p> <p>The Authority did consider whether this information could be provided in addition to the financial statements but determined that this would add complexity to the penalty calculation, could potentially create distortions in the calculation and would likely lose the transparency we are seeking.</p>
<p>[The Company] have no comments to make in respect of the above CP [consultation paper]. We support the moves to formalise policy on levying discretionary civil penalties in the interests of fairness, transparency and consistency across regulated sectors.</p>	<p>Thank you for your comments.</p>
<p>From Reviewing the draft regulations in this Consultation, we believe that our initial feedback in relation to the proposed methodology has been taken into account; however, we would encourage the Authority to consider the impact of IFRS17 on the presentation of financial statements (i.e. availability of information to calculate the relevant income).</p>	<p>Following receipt of the consultation responses the Authority spent a considerable amount of time trying to determine a transparent way to determine relevant income that was fair to all insurers regardless of the accounting standards they report under. The Authority has no appetite for a dual definition based on accounting standard used.</p> <p>In light of this, at this time the Authority believes the proposed definition of relevant income remains appropriate. The definition has been amended slightly to allow insurers to use the definition of premium reported under their relevant accounting standard</p>

Responses from authorised long-term business insurers	
Insurer's response	Authority's response
<p>In addition it should be noted that the definition of Insurance Contracts and Investment Contracts within page 2 of the draft regulations seem to have been transposed incorrectly in that the definition for Insurance Contracts is for the Investment Contracts and vice versa.</p>	<p>(i.e. written premium, earned premium or (under IFRS17) premium received). We don't anticipate this will create material discrepancies in the relevant income calculation across insurers using different accounting standards.</p> <p>As IFRS17 embeds and other accounting standards establish their future positions in light of IFRS17, the Authority will review whether this definition of relevant income continues to be appropriate.</p> <p>Thank you for your comments. This will be amended.</p>

Responses from insurance intermediaries	
Insurance Intermediary Response	The Authority's response
<p>The proposal states that the penalties will be based on the overall turnover for the company. This feels slightly unjust as some companies (such as ourselves) hold more than one licence so the turnover could be higher than say a stand-alone insurance company, meaning an inflated penalty for companies who specialise in other regulated areas.</p> <p>As the fees for the different licence classes are separate (as well as reporting) we feel the penalties should align with this i.e. the % based on the licence area which is impacted (in this case insurance).</p>	<p>A discretionary civil penalty will only be issued following a serious regulatory failing. Depending on the nature of the failing, it is possible the failing is symptomatic of issues affecting the entity as a whole.</p> <p>The Authority deems it appropriate for a civil penalty to be based on the total turnover of a regulated entity (the majority of which should be related to regulated activities). This prevents the possibility of turnover allocation between regulated and unregulated activities being exploited to achieve a lower penalty and also enables turnover to be obtained from an entity's financial statements, which is key for transparency.</p>

3. Changes to the Proposals

The following changes have been made to the Regulations:

- (1) The definition of 'Insurance Contract' and 'Investment Contract' have been amended so that the definition of insurance contract and investment contract are now the correct way around. The corrected definitions are:

***"insurance contracts"** means contracts issued by the insurer that are identified to be insurance contracts under Financial Reporting Standards or International Financial Reporting Standards;*

***"investment contracts"** means contracts issued by the insurer that are identified to be investment contracts under either Financial Reporting Standards or International Financial Reporting Standards;*

- (2) The definition of 'fee income' has been amended to remove the element of guidance that is not required in regulation. This will enable the applicable items of income to be determined based on the accounting treatments used by insurers.

Old definition:

***"fee income"** means all fees received by an authorised insurer for services provided on investment contracts, such as annual management fees, policy administration fees, commission income, amortisation of actuarial funding and amortisation of deferred income such as front end/origination fees;*

New definition:

***"fee income"** means all fees received by an authorised insurer for services provided on investment contracts;*

- (3) The ability to use premiums received as an alternative to written premium when this is the amount reported in the accounts (under IFRS17) has been added.

Old wording:

Earned premiums may be used in place of written premiums if this is the premium measure reported in the financial statements.

New wording:

Earned premiums or premiums received may be used in place of written premiums if this is the premium measure reported in the financial statements.

The final version of the Regulations is attached to this consultation response.

The following changes have been made to the Guidance Note:

- (a) In section 1.1 (page 4), the phrase ‘existing licenses’ has been corrected to ‘existing licences’.
- (b) In footnote 1 (page 5), the phrase ‘Any reference in this document to a ‘regulations’’ has been corrected to ‘Any reference in this document to ‘regulations’’.
- (c) In section 1.3 (Discretionary Civil Penalties) (page 7), the phrase ‘Such penalties are an intermediate disciplinary measure’ has been replaced with ‘Such penalties are a disciplinary measure’ to reflect the fact that most discretionary civil penalties issued to date have related to more significant disciplinary matters.
- (d) In section 3.3.1 (Determining the applicable Penalty Level) (page 12), a footnote (5) has been added to reference the ‘relevant income’ definition in regulation 3 (Interpretation) of each of the Financial Services (Civil Penalties) Regulations 2015 and the Insurance (Civil Penalties) Regulations 2022.
- (e) In section 3.3.1 (Determining the applicable Penalty Level) (page 13), the following text has been omitted along with the pyramid diagram to reflect the fact that most discretionary civil penalties issued to date have fallen within Level 2:
‘However, the Authority anticipates that most discretionary civil penalties will fall within Level 1 rather than Level 2. This relationship is displayed in the pyramid diagram below along with the applicable percentages of relevant income.’
- (f) In section 3.3.3 (Ascertaining relevant income) (page 15), replaced ‘prescribed date’ with ‘date prescribed in the Regulations’ for clarity.
- (g) In section 4 (Discount Facility) (page 18), a footnote (7) has been added to clarify the application of the 30% discount.

The final version of the Guidance Note is published on our website².

4. Next Steps

The Authority will proceed to make the Insurance (Civil Penalty) Regulations 2023.

In case of any query, please contact the undersigned —

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² <https://www.iomfsa.im/media/1432/discretionarycpguidance.pdf>