



**ISLE OF MAN
FINANCIAL SERVICES AUTHORITY**

Lught-Reill Shirveishyn Argidoil Ellan Vannin

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

CP22-03

Issue Date: 06 May 2022
Closing Date: 24 June 2022

Consultation Paper – CP22-03

This Consultation Paper is issued by the Isle of Man Financial Services Authority, which is the regulatory body for financial services in the Isle of Man.

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

The closing date for comments is **24 June 2022**.

Please send comments in writing and preferably by email to:

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If you have a query in relation to how this consultation has been carried out, please contact the Authority's Policy and Authorisations Division by email at Policy@iomfsa.im or by telephone on +44 (0) 1624 646000.

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Glossary

Authority	Isle of Man Financial Services Authority
Act	Insurance Act 2008
Fee income	All fees received by an 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.
Relevant income	<ul style="list-style-type: none"> • for an authorised insurer: fee income on investment contracts (gross of reinsurance and commission) plus written premiums on insurance contracts (gross of reinsurance and commission) less the movement in unearned premium reserve; • for an authorised insurer who reports zero fee income and zero written premiums in its financial statements: where the movement in reserves is a positive movement, the movement in reserves (gross of reinsurance) less claims paid (gross of reinsurance) or else an amount determined by the Authority. • for an insurance manager or intermediary: annual turnover.

Serious regulatory failing	A serious contravention of the Act or any prohibition or requirement imposed under the Act
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1. Executive Summary

1.1 What is the purpose of this Consultation Paper?

The purpose of the consultation is to obtain views and evidence in relation to the making of regulations in respect of discretionary civil penalties on entities regulated under the Insurance Act 2008.

1.2 Who may be affected by this Consultation Paper?

The consultation will be of direct interest to all former, existing and prospective authorised insurers, permit holders, registered insurance managers and registered insurance intermediaries.

Other parties with an interest in the Isle of Man insurance sector may also find this consultation paper and the issues raised of interest.

2. Consultation Process

2.1 The Authority's regulatory objectives

The Authority's regulatory objectives are set out in section 2(2) of the FSA08 as —

- (a) securing an appropriate degree of protection for policyholders, members of retirement benefits schemes and the customers of persons carrying on a regulated activity;
- (b) the reduction of financial crime; and
- (c) the maintenance of confidence in the Island's financial services, insurance and pensions industries through effective regulation, thereby supporting the Island's economy and its development as an international financial centre.

The Authority is required to give consideration to certain factors when discharging its functions in accordance with paragraph 3 of Schedule 1 to the FSA08. The most relevant factors for this consultation are considered as follows:

Factor	Information
The international character of the financial services, insurance and pensions industries and their markets and the desirability of maintaining the competitive position of the Island.	The implementation of civil penalties is part of the Island maintaining its position as a reputable and responsible international financial centre.

2.2 Responding to the Consultation Paper

Open dialogue with stakeholders is an essential element for successful development of the Authority's proposals. Constructive feedback will help the Authority reach an informed decision on the content of the proposals and manner of implementation. Respondents should note the following when responding to this Consultation Paper:

- As responses to the consultation may be subject to publication or disclosure in accordance with access to information regimes, respondents should state if they wish their response to remain confidential and, if so, the reasons for this.
- Submissions received by the closing date of the consultation will be considered but may not necessarily result in a change to the proposals following a review of all responses received.
- Professional bodies, trade associations and other representative groups should provide a summary of the people and organisations they represent when responding to a consultation as well as the methodology used to gain members' input.
- The Authority requests that submissions are not made anonymously as they will not be considered or included in the Consultation Response.

This Consultation Paper has been published on the Authority's website and the Isle of Man Government's Consultation Hub¹.

3. Proposals

3.1 Levying of discretionary civil penalties

The Authority is looking to formalise its policy on levying discretionary civil penalties and is proposing to issue the Insurance Civil Penalty Regulations 2022 ('the Regulations')(attached in appendix A), which set how the penalty will be determined. Where appropriate, a consistent approach to that prescribed under the Financial Services (Civil Penalty) Regulations 2015 ('the FSA Regulations') is proposed.

Under Section 37 of the Act, the Authority has the power to levy civil penalties on a regulated entity. For the purpose of the Regulations, we are only considering discretionary civil penalties where there has been a serious regulatory failing.

Under Section 37, civil penalties can also be imposed:

- for a breach of administrative requirements where there has been a contravention of a requirement to submit or otherwise a return within a specified period (an 'administrative civil penalty');
- on a controller, director, chief executive or senior manager if the contravention was caused or permitted by one of these persons;

¹ <https://consult.gov.im/>

These types of penalties are being considered further and will be consulted on later.

The Authority intends to adopt the same Enforcement Decision-Making Process for imposing discretionary civil penalties as is currently in force under the Financial Services Act 2008. A marked up version showing the amendments made so that the guidance applies to entities regulated under the Insurance Act 2008 is provided in Appendix B.

The key components to the discretionary civil penalties framework are:

- A defined volume measure to which the levy percentage can be applied (i.e. relevant income); and
- A range of levy percentages and guidelines for determining which percentage applies.

3.2 Relevant income

It is key that that definition of relevant income is transparent and certain and so it is proposed that, to the greatest extent possible, the components for determining relevant income should come from an insurer's annual financial statements.

To be consistent with Financial Reporting Standards and International Financial Reporting Standards, the proposed definition for authorised insurers differentiates between investment contracts and insurance contracts.

Investment contracts

The approach for investment contracts recognises the bulk of the income received is offset by a corresponding policyholder liability as the 'allocated' premium is invested in appropriately matching assets (policyholder units for unit-linked business).

Relevant income for investment contracts is proposed as fee income from all fees received for services provided 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. These should be gross of reinsurance and net of commission.

Insurance contracts

The approach for insurance contracts is a typical definition, representing the earning of premiums.

Relevant income for insurance contracts is proposed as written premiums less any change in unearned premium provision. These should be gross of reinsurance and net of commission.

Total relevant Income

The total relevant income for an authorised insurer will be the sum of its relevant income for investment contracts and insurance contracts.

Relevant income will be based on the authorised insurer's financial statements for the financial year-end immediately prior to the authorised insurer's notification of, or the Authority's identification of, a serious regulatory failing.

Relevant income will be net of commission. For this purpose alone, commission is defined as remuneration paid by an insurer to an external intermediary, broker or introducer, either at the commencement of a policy or on an ongoing basis. In order for commission to be netted from relevant income, any commission item(s) must be paid from the associated fee income or written premium, and be clearly identifiable in the insurer's financial statements. Intragroup commissions are excluded and should not be netted off relevant income.

Relevant income will be gross of reinsurance to avoid insurers who reinsure significant parts of their books benefitting from a lower civil penalty than their counterparts, simply due to their reinsurance strategy.

Insurers in Run-Off (i.e. no fee income or written premium)

Based on the above core definitions for investment and insurance contracts, an insurer that has no fee income, and has ceased to write new insurance business is in run-off. In this circumstance, the Executive considers it appropriate to levy a penalty based on an insurer's gross claim movements, where this is defined as:

- Where the movement in claims reserves is positive movement, the movement in claims reserves less claims paid, where both amounts are gross of reinsurance.
- Where the movement in claims reserves is a negative movement, it is proposed the Authority has discretion as to the fine levied.

Insurance Managers and Insurance Intermediaries

For other regulated entities such as registered insurance managers and registered insurance intermediaries, the proposed definition of relevant income is annual turnover, in line with the FSA Regulations.

3.3 Determining the amount of discretionary civil penalty

The amount of discretionary civil penalty will depend upon the seriousness of the regulatory failing, as well as the willingness of the regulated entity to cooperate with the Authority in any investigation proceedings and to take appropriate steps to remedy the serious regulatory failing.

The table overleaf sets out two levels of civil penalty payable depending upon the seriousness of the regulatory failing. The definition of each level and the proposed penalty percentage has been set consistently with the levels and penalties applied under the Financial Services (Civil Penalty) Regulations 2015.

DISCRETIONARY CIVIL PENALTY	Percentage
<p>Level 1</p> <p>A penalty may be imposed at this level in cases where there has been a serious regulatory failing where any of the following factors are present but none of the factors in Level 2 are present —</p> <ul style="list-style-type: none"> (a) the serious regulatory failing has resulted in a risk of significant loss to any of the regulated entity’s customers; (b) the serious regulatory failing has resulted in a significant risk of financial crime; or (c) the serious regulatory failing is attributable to serious negligence by any of the regulated entity’s directors, controllers, principal control officers, managers or the chief executive. 	<p>Up to 5% of relevant income</p>
<p>Level 2</p> <p>A penalty may be imposed at this level in cases where there has been a serious regulatory failing where any of the following factors are present —</p> <ul style="list-style-type: none"> (a) the serious regulatory failing has resulted in a significant loss to any of the regulated entity’s customers; (b) the serious regulatory failing has resulted in financial crime; (c) the serious regulatory failing was incurred deliberately by any of the regulated entity’s directors, controllers, principal control officers, managers or the chief executive in order to obtain a benefit or mitigate a loss; (d) any of the regulated entity’s directors, controllers, principal control officers, managers or the chief executive have attempted to conceal the serious regulatory failing from the Authority; or (e) the serious regulatory failing is attributable to serious deficiencies in any of — <ul style="list-style-type: none"> (i) the regulated entity’s corporate governance; (ii) the regulated entity’s systems and internal controls; or (iii) the fitness and propriety of any of the regulated entity’s directors, controllers, principal control officers, managers or the chief executive. 	<p>Up to 8% of relevant income</p>

If the Authority determines that the insurer fully cooperated in the investigation, and has taken or plans to take sufficient steps to rectify the situation to the Authority’s satisfaction, the penalty can be reduced by 30%.

4. Impact Assessment

The Authority already has the power to levy discretionary civil penalties; this regulation is simply providing transparency around the determination of a levy that is appropriate to the

seriousness of the regulatory failing. This provides greater clarity to the regulated sector and greater certainty to the decision making process in the event of a serious regulatory failing.

5. Questions

The Authority invites general feedback on the proposals set out in this consultation paper.

6. Next Steps

Following closure of the consultation period, the Authority will review the responses received and publish a Consultation Response document on the Authority's website and the Isle of Man Government's Consultation Hub. Subject to those responses, the Authority may proceed to make the Insurance (Civil Penalty Regulations) 2022.