



Insurance Newsletter

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**Financial Services
Commission**

Legislative Changes Affecting Insurance Companies and Their Auditors

Introduction

The purpose of this Newsletter is to inform insurance companies and their auditors of the recent legislative changes affecting licensed insurance companies. Since the last Newsletter, issued in May 1997, two further important pieces of insurance legislation have been introduced:-

- The Insurance Companies (Prudential Supervision) Regulations 1997; and
- The Insurance Companies (Auditors) Regulations 1997

The first will be of interest to insurance companies and their auditors, whilst the second applies mainly to auditors of insurance companies.

The Insurance Companies (Prudential Supervision) Regulations 1997

A note explaining these Regulations is attached at Appendix A. Please note that all insurance companies to which the Regulations apply need to take immediate action to notify the Commissioner of any "close links" which the insurer has, and which have not already been reported to the Commissioner, which may prevent the effective supervision of the company. This is required by Regulation 7. This, and the immediate action to be taken, are explained in paragraphs 18 - 26 of Appendix A.

To avoid a breach of Regulation 7, Gibraltar insurers must provide the required information to the Commissioner by 5th December 1997. If any such companies believe they have close links, but may not be able to report them by then, they should inform the Insurance Supervisor or the Assistant Insurance Supervisor immediately.

The Insurance Companies (Auditors) Regulations 1997

These regulations impose a duty on auditors of a licensed insurance company to report to the Commissioner any matters which come to light during the course of work undertaken, in their capacity as auditors, and which are relevant to any of the functions of the Commissioner under the Ordinance. The circumstances in which such reports should be made and the matters to be reported are set out in more detail in Appendix B.

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Appendix A

The Insurance Companies (Prudential Supervision) Regulations 1997

Introduction

1. These Regulations implement the provisions of the Prudential Supervision Directive (95/26/EC), sometimes referred to as the "Post BCCI Directive". The Directive applies to banks, building societies, insurance companies, friendly societies, investment firms and undertakings for collective investments in transferable securities. These Regulations apply only to insurance companies affected by the Directive and came into effect on 6th November 1997.

Background

2. The purpose of the Directive is to reinforce prudential supervision by filling in some of the gaps exposed by the BCCI affair. It addresses some of the problems highlighted in the Bingham report into BCCI's collapse.

Summary of effect of the Directive

3. The Directive has effect in four main areas:

Close links

The Directive requires a licence to be refused or withdrawn where close links with other natural or legal persons, or the laws to which a closely linked person is subject, or difficulties involved in the enforcement of such laws, prevent effective supervision. Insurance companies are required to provide all information necessary to ensure compliance;

Location of head office

The Directive requires insurance companies to have their head office in the same member state as their registered office;

Gateways

It allows for the widening of some disclosure "gateways".

Duty on auditors to report

It reinforces and extends the requirement on auditors to report.

Application to insurance companies

4. The effect of the Directive is to amend earlier insurance directives. The implementing Regulations apply, therefore, only to insurance companies to which the Insurance Directives apply or can be applied. The regulations apply in their entirety to Gibraltar insurers as defined in section 2(2) of the Insurance Companies Ordinance 1987 ("the Ordinance").

In the Ordinance, a "Gibraltar insurer" means an insurance company -

- (a) which is incorporated in Gibraltar;
- (b) whose head office is in Gibraltar;
- (c) which is licensed in Gibraltar;



- (d) whose business is not restricted to -
 - (i) reinsurance business;
 - (ii) business which is excluded from the first long term insurance Directive by Article 2(2) or (3) of that Directive;
 - (iii) business which is excluded from the first general insurance Directive by Article 2(2)(b) of that Directive; and
 - (iv) business which is exempted from the authorisation requirements by Section 18 of this Ordinance; and
- (e) which is not excluded from each Directive mentioned in sub-section (d) by Article 3 of that Directive.

The regulations, therefore, do not apply to:-

- Pure reinsurers (provided their business is restricted to reinsurance)
 - Provident and mutual benefit institutions exempted by Article 2.2(b) of the First Non-Life Directive (73/239/EEC), and
 - Small mutuals exempted by Article 3 of the First Non-Life Directive.
5. The Directive's provisions, apart from the location of head office requirement, will be applied to non-EEA insurers carrying on insurance business in Gibraltar through a branch or agency.

Organisation of the Regulations

6. The Regulations implement the Directive largely by means of amending the Ordinance. This note looks at the Regulations in terms of functions as follows:

Close links and location of head office

- Regulations 3 & 5 Restrictions on issue of licence by the Commissioner of Insurance ("the Commissioner") (close links and location of head office); and withdrawal of licence. The definition of close links is in regulation 2.
- Regulation 7 Duty to notify close links to the Commissioner (close links).

Passing of information

- Regulation 4 Communication by auditor with the Commissioner (duty on auditors to report)
- Regulation 6 Disclosure of information by the Commissioner (gateways)

Approach to implementation

7. The approach to implementation has been to make maximum use of existing systems where these already fulfil the requirements of the Directive, or can be extended to do so. This has been in order to avoid duplication, and to keep the additional burden imposed by the Regulations at an absolute minimum consistent with good supervision.



Regulation 3 - Restrictions on issue of licence by the Commissioner

8. The effect of Articles 2 and 3 of the Directive is to introduce into Article 8(1) of the First Directive two additional prohibitions on licensing. These are implemented by Regulation 3 which inserts a new section 27 into the Ordinance.

Unsuperviseable structure

9. Sub-section (1) applies to Gibraltar insurers and non-EEA insurers, and implements the requirements of Article 2(2) of the Directive that a licence should be withheld where close links between the applicant and other legal or natural persons, or the laws to which closely linked persons are subject, or difficulties in their enforcement, prevent the effective exercise of the Commissioner's functions under the Ordinance.
10. A licence should be withheld or withdrawn if central management functions of the insurance company are delegated to closely linked persons who are outside the scope of Gibraltar regulation, either because they are not subject to the fitness powers of the Commissioner, or because they are geographically outside his jurisdiction.

Location of head office

11. Sub-section (3) applies only to Gibraltar insurers (see paragraph 4 above). It implements the requirement of Article 3 of the Directive that insurance companies must have their head office in the same member state as their registered office. The effect is to prevent the Commissioner issuing a licence to carry on insurance business to a Gibraltar incorporated applicant if its head office is outside Gibraltar.
12. A licence will be withdrawn if a Gibraltar licensed insurance company removes its head office from Gibraltar's jurisdiction. There is no definition of head office in the Regulations. However, the Commissioner continues to regard the head office as being located where the company's mind and management is. The head office should be more than merely an address from which compliance reports such as Annual Returns and Statutory accounts are filed; it should be the place where the management decisions of the company are habitually taken.
13. This sub-section will not prevent a company which is incorporated in Gibraltar but which carries on no insurance business here from being licensed to carry on insurance business elsewhere. However, any such company would need to repatriate its head office to Gibraltar if it wished to carry on insurance business here.
14. The intention behind this is that it should not be possible for a Gibraltar incorporated company to seek a licence under section 25 of the Ordinance as a non-EEA insurer on the grounds that its head office is not in a member state and, thereby, be subject to a less strict supervisory regime. Some of the Commissioner's powers, e.g. section 42, section 61A and Schedule 11 are not available in respect of non-EEA insurers, and their shareholder controller threshold is set at 15% not 10%.

Regulation 5 - Withdrawal of licence.

15. Articles 2 and 3 of the Directive, by virtue of the amendments they make to Article 8(1) of the First Directives, attract the provisions of Article 22(1)(b) of the First non-Life Directive and Article 26(1)(b) of the First Life



Directive that authorisation may be withdrawn if an insurance company no longer fulfils the conditions of admission.

16. Although the Directive does not provide for it, it was recognised that withdrawal, or suspension, of a licence to enter into new contracts alone could provide an inadequate response in the event that unsuitable close links are discovered, or created, or in the event that a Gibraltar insurer “exports” its head office. Powers have been provided for the Commissioner to intervene in such circumstances. The Commissioner also has the discretion to deal with unsuitable close links or the export of a head office by means of intervention short of withdrawal or suspension of a licence if he considers it appropriate.
17. Regulation 5, therefore, extends the grounds in Section 105(2)(b) on which a licence may be withdrawn under Section 105 to include the new section 27. A similar amendment is also made to the ground set out in Section 107(2)(f) on which the powers of intervention contained in Sections 55, 82, 98, 100 and 100A may be exercised.

Regulation 7 - Duty to notify close links to the Commissioner.

18. The Directive requires insurance companies to provide the Commissioner with all the information he needs to check that close links which prevent effective supervision are not set up. This means that the Commissioner needs to be told whenever a new close link is established. Regulation 7 introduces, therefore, a new duty to notify close links.
19. As paragraph 26 indicates, some close links are already reported through the Section 41 change of control procedure. The Regulation 7 duty to notify applies, therefore, only to close links which are not already reported under Section 41.
20. Under Regulation 7(2), insurance companies are given 30 days in which to notify the establishment of a close link other than one to which section 41 applies. Regulation 7(3) requires the notification to include the name of the closely linked person, and the nature of the close link. In addition, a minimum of details to establish identity are required by Regulation 7(4). For bodies corporate, these are:

- the place of incorporation, and
- (if applicable) registered number.

For natural persons, the particulars are:

- date and place of birth.

Where a partnership establishes close links with an insurance company, the particulars must be provided in respect of each partner. Failure to notify the establishment of close link attracts penalties (Regulation 7(5)).

21. The immediate effect of the duty to notify is that, within 30 days of 6th November 1997, the Commissioner should receive notifications in respect of existing close links where the closely linked person does not fall within the definition of controller in Section 2(15) of the Ordinance.
22. Any insurance company which fails to notify its existing close links (excluding controllers) by 6th December 1997 will be in breach of the Regulations. A structure chart containing the prescribed particulars will be regarded as an adequate response. Any insurance company which has difficulty in deciding whether or not a person is closely linked should



contact the Insurance Supervisor or Assistant Insurance Supervisor for advice.

23. The mere existence of a close links does not, in itself, prevent the effective exercise of our supervisory functions. What matters in this regards is how the link is used (or abused).

Regulation 2 - Definition of close links

24. Close links are defined in regulation 2 and the Schedule. The definition in Article 2 of the Directive is complex and has required the implementation of a slightly wider definition of the terms "parent undertaking" and "subsidiary undertaking". The addition is set out in paragraph 2 of the Schedule to the Regulations and deals with a situation which is generally regarded as very unlikely to occur in Gibraltar.
25. The definition in the Regulations does not correspond with the design in the Ordinance. As the Directive sets the floor for close linkage at 20%, for the purposes of the Regulations any shareholding of 20% or more is regarded as constituting parenthood.
26. Close links work in three directions; upwards, downwards and sideways. The following categories of natural or legal persons are regarded as closely linked to an insurance company. Where such categories are already notified to the Commissioner under section 41 of the Ordinance, they are shown in italics.

Upwards links

20% shareholder controllers of the insurance company;

33% shareholder controllers of the insurance company;

50% shareholder controllers of the insurance company;

majority shareholder controllers of the insurance company;

any person who falls within the definition of controller in section 2(15)(c) of the Ordinance;

any person who is a parent undertaking within the meaning of paragraph 2 of the Schedule to the Regulations.

The above definitions require, as is currently the case, the notification of all 'upwardly linked' shareholders, including the ultimate controller.

Downwards links

Any body corporate in respect of which the insurance company, either directly or by way of control (i.e. through a subsidiary), owns 20% or more of the capital, or holds 20% or more of the voting rights of any legal person which is a subsidiary undertaking within the meaning of paragraph 2 of the Schedule to the Regulations.

Sideways links

Any fellow subsidiary undertaking of a parent undertaking of an insurance company;

any company which is majority owned or controlled by a natural person who has majority ownership or control of the insurance company.



Regulation 4 - Communication by auditor with the Commissioner

27. Article 5 of the Directive requires that people undertaking audits, or other statutory tasks, in insurance companies should report to the Commissioner facts or decisions which are liable to:
 - constitute material breaches of the law, regulations and administrative provisions which lay down the conditions governing authorisation or which specifically govern the carrying on of insurance business;
 - affect the continuous functioning of the insurance company, or
 - lead to refusal to certify the accounts, or to the expression of reservations.
28. Where the auditor of an insurance company also carries out an audit, or other statutory task, in a holding company or in a subsidiary company of the insurance company, there is likewise a duty for him to report any such facts, or decisions, of which he becomes aware in the course of auditing the holding company or subsidiary company.
29. The Article provides that such disclosures by auditors made in good faith should not constitute any breach of any restriction on disclosure imposed by contract, or by legislative, regulatory or administrative provision, nor should it involve the auditor in liability of any kind. Article 5 has been applied to Gibraltar insurers and to non-EEA insurers.
30. Section 48A of the Ordinance which was introduced by the Insurance Companies (Amendments) Ordinance 1997 and came into effect on 6th March 1997 together with the Insurance Companies (Auditors) Regulations 1997 ("the Auditors Regulations") which came into effect on 23rd October 1997 already cover much of the ground covered by Article 5. However, implementation required the scope of Section 48A to be extended to cover auditing of holding companies and of subsidiary companies.
31. Regulation 4, therefore, substitutes a revised Section 48A(1), extending the scope of the section to include an auditor of any body to which an insurance company is closely linked by way of control who is also an auditor of the insurance company. (For further information on auditor's duties to report, please see Appendix B).

Regulation 6 - Disclosure of information by the Commissioner ("gateways")

32. Article 4 of the Directive permits the widening of the "gateways" in Schedule 16 to the Ordinance to include a number of additional persons, or bodies, in respect of insurance companies. They are listed in paragraphs 33 to 36 below. Disclosure is, however, subject to conditions, and different conditions are applied to different bodies and persons. Paragraphs 33 to 36 are, therefore, organised in terms of the conditions to which disclosure is subject.
33. Under the terms of Article 4(1) disclosure by the Commissioner is permitted, for the purposes of legal supervision, to actuaries carrying out functions under the Ordinance.
34. For the purpose of oversight, disclosure by the Commissioner to the following is permitted :



- bodies responsible for supervising actuaries carrying out functions under the Ordinance (i.e. the Institute of Actuaries and the Faculty of Actuaries);
 - the authorities for overseeing the work of bodies involved in the liquidation and insolvency of insurance companies and other similar procedures;
 - the authorities responsible for overseeing the persons charged with carrying out statutory audits of the accounts of insurance companies (i.e. the accountancy professional bodies);
35. With the aim of strengthening the stability, including integrity, of the financial systems, disclosure by the Commissioner to the following is permitted;
- authorities or bodies responsible under the law for the detection and investigation of breaches of company law;
36. For the performance of their tasks, disclosure by the Commissioner to the following bodies is permitted :
- central banks, and other bodies with a similar function, in their capacity as monetary authorities and
 - where appropriate, to other public authorities responsible for payment systems.
37. In all cases covered by paragraphs 33 to 36 above, information disclosed by the Commissioner is subject to the obligation of professional secrecy.

Reporting of information

38. To enable insurance company to report close links to us, we attach pro-forma notification documents which may be of assistance.



Appendix B

The Insurance Companies (Auditors) Regulations 1997

1. These regulations, which came into effect on 23rd October 1997, were made under section 48A(2) and (3) of the Ordinance. They should be read in conjunction with section 48A of the Ordinance and the Insurance Companies (Prudential Supervision) Regulations 1997.
2. The Regulations impose a duty on an auditor of an insurance company licensed under the Ordinance, or an auditor of a body to which an insurance company is closely linked by control, who is also auditor of the insurer. Under this duty, he is required to report to the Commissioner any matters which are relevant to any of the functions of the Commissioner under the Ordinance, if those matters are, or may be, of material significance to the Commissioner in deciding whether to use any of his powers of intervention under sections 55, 64D to 66B, 82, 98, 100 or 100A of the Ordinance.
3. It is a duty of auditors to report direct to the Commissioner, in defined circumstances, information which has come to their attention in the course of work undertaken in their capacity as auditors. They are not required to carry out work over and above that necessary for their report on financial statements and other reports specified by legislation, or by the Commissioner.
4. Auditors will be familiar with Statement of Auditing Standards 620 (SAS 620) on the Auditors' Right and Duty to Report to Regulators in the financial sector and reference should be made to this publication along with APB Bulletin 1996/2.
5. Matters to be reported to the Commissioner include :-
 - circumstances indicating that the insurance company's licence could be revoked;
 - there is, has been, or may be or may have been, either
 - (i) a failure to fulfil specified requirements, or
 - (ii) a contravention of other provisions of the Ordinance which is likely to be of material significance to the Commissioner for the exercise of his functions;
 - there is doubt as to the company's status as a going concern;
 - the auditors conclude that their report on the financial statements should include a qualified opinion.
6. The duty to report not only applies to information to which auditors become aware of in their capacity as auditors of the insurance company. It also extends the application of the duty to information of which auditors become aware in the context of their work as auditors of a body which is closely linked by control to the insurance company.
7. Therefore, where auditors of an insurance company are also auditors of an entity closely linked by control, there is a duty to report relevant information they become aware of in the course of their work as auditors of that entity. No duty is imposed on auditors of an entity closely linked to an insurance company who are not also auditors of the insurer. It should also be noted that the duty applies only to information relevant to the insurance company.



8. Auditors will need, therefore, to take steps in planning their audit work to determine whether there are close links between insurance companies to which they are appointed as auditors and other entities to which they are also appointed as auditors.



Licensed Insurance Company Which Has Become Closely Linked With A *Body Corporate*, But Where The Latter Has Not Also Become A Controller Of The Insurer

Particulars To Be Provided

Name of licensed insurance company:				
Name of body corporate which has become closely linked.	Date of incorporation and registered number.	Country of incorporation.	Nature of the close links to which the notification relates.	Date on which the close links were established.

*Notes: Dates shall be given in the order **day/month/year**.*

Signed (directort/secretary†) Date
of **

** Insert name of the licensed insurance company

† Delete as appropriate