

**SUPERVISORY MANUAL**

**FOR THE JORDANIAN**

**INSURANCE  
COMMISSION**

GAD November 2004

Revised by LS&A 2006

**MANUAL FOR THE INSURANCE COMMISSION ON INSURANCE RISKS  
AND ACTUARIAL SUPERVISION OF INSURANCE COMPANIES**

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## 1 INTRODUCTION

### 1.1 Purpose of this manual

The purpose of this manual is to

- specify the risks that insurance companies are exposed to, including not only actuarial risks but risks more generally;
- specify financial ratios that should be calculated for insurance companies assuming that sufficient information is available in supervisory returns;
- provide an overview of the actuarial considerations to be taken into account when assessing the returns submitted by insurance companies.

It is anticipated that this manual will then assist the Jordan Insurance Commission (“Commission”) to meet its regulatory objectives, and generally to supervise the insurance companies for which it is responsible as effectively and efficiently as possible.

The manual is for internal use by the Commission only, and should not be shared with the insurance companies.

**None of the material in this manual should be transmitted to third parties, reproduced or copied without the express prior consent of GAD. Where consent is granted to the Commission to share any part of the manual with a third party, GAD will not permit the third party to rely upon that information, and will not accept any responsibility to the third party for that information in any circumstances.**

Whilst every effort has been taken to ensure that the material in this manual is relevant to the Commission, accurate and complete, all functions under insurance law and regulations are exercised by the Commission alone. **GAD does and will not accept any responsibility to the Commission for actions taken by it based on material contained in this manual under any circumstances.**

Updates and amendments to the manual should be considered whenever necessary. Suggestions for additions or revisions to it are welcomed from all Commission staff.

### 1.2 Objectives of the Commission

#### 1.2.1 Statutory requirements

The Insurance Regulatory Act specifies the authority and functions of the Director General. These include:

- the administrative supervision of the application of the provisions of the Act;
- the supervision of the operation of Jordanian insurance companies and foreign insurance companies carrying on business in the Kingdom;
- the supervision of the activities of persons carrying on intermediation business;

**Comment [G1]:** Assuming the Commission now owns and controls this manual, the text in bold on this page may no longer be appropriate. Suggest deleting.

**Comment [d2]:** S. 15 of Act lists functions and authority of DG in a more general way than they appear here.

- being concerned with the securing of the fulfilment of insurance companies' and intermediaries' obligations, and bearing responsibility for observing the legality of their activities and upholding the interests of policyholders;
- the granting and withdrawal of licences to carry on insurance business;
- the taking of measures prescribed by the Act in the event of violation of the Act;
- the exercise of preventive or suppressive control consistent with the provisions set out in the Act.

### 1.2.2 Regulatory objectives

The statutory requirements in section 1.2.1 are consistent with, and should be viewed against a background of, the following regulatory objectives, which are common to regulators of insurance companies generally.

ICP 2(b) from the IAIS core principles states that:

*The key objectives of supervision promote the maintenance of efficient, fair, safe and stable insurance markets for the benefit and protection of policyholders.*

Policyholder protection is, therefore, usually thought of as the primary supervisory objective.

#### 1.2.2.1 *Policyholder protection*

An insurance company takes on liabilities to its policyholders. Premiums are received before benefits are paid (typically a long time before for life insurance policies). The benefits payable are also uncertain both in amount (especially for general insurance policies) and timing. The logical conclusion from this is the need for protection for policyholders, to ensure as far as possible that the benefits to which they are entitled under the terms of their policies are paid to them when due.

One important way in which protection for policyholders can be given is to insist that the assets held by an insurance company must be at least as great as the provisions and reserves for all business in force, calculated in a specified way. This leads to the concept of specific **asset and liability valuation rules**. Such protection can be improved by insisting that the assets must exceed the liabilities by a specified amount. This leads to the concept of a **minimum solvency ratio**. Both of these concepts are reflected in provisions of the Act, Instructions and Decisions, and are covered in more detail in sections 2 and 3 respectively of this manual.

#### 1.2.2.2 *Maintain orderly market*

Related to the previous point, effective regulation giving protection for policyholders will help maintain confidence in the insurance industry. Another aspect to this is for the Commission to seek to **reduce** the extent to which it is possible for a person to use their insurance business in a connection with **financial crime**. Confidence in the industry will be maintained only if things are not only done properly but also seen to be done properly. The Commission should therefore seek to ensure **reasonable transparency** in the insurance industry in line with international best practice.

### *1.2.2.3 Facilitate competition*

Protection for policyholders needs to be pitched at the right level, so as not to unduly constrain the activities of insurance companies. This, and the maintenance of an orderly market, will help encourage entry to the market and facilitate competition and innovation, to the benefit of consumers. It will also help ensure the continued **availability of insurance**. The Commission should therefore not intervene in the running of insurance companies unnecessarily or disproportionately, nor take on the duties or responsibilities of their directors.

### *1.2.2.4 Promote public awareness*

One aspect of protecting policyholders is enabling them to make more informed decisions for themselves. This will be achieved if they have a greater understanding of the insurance industry, and the Commission should therefore seek to promote this. Ensuring maximum transparency, as mentioned above, will also help in this regard.

### *1.2.2.5 Protect national interest*

The insurance industry is a significant part of Jordan's economy and maintaining it in good health is therefore in the national interest. The regulatory regime should be pitched at a level sufficient to meet international obligations (including cooperating with other regulators overseas) but not such as to prejudice the national interest compared with competitors overseas. In meeting its objectives, the Commission should use its resources in the most efficient and economic way, in order to maximise the overall national interest. It should also at all times remain aware that it is accountable to the government, the courts and the public.

### *1.2.2.6 Development of the Insurance Industry*

The Insurance Commission is seeking to help the Jordanian insurance industry to develop, and to adopt international best practice.

The Commission does, therefore, need to try to work closely with the Insurance Industry, and to facilitate training and development programmes.

## **1.3 Implications for the Commission**

In order to meet its regulatory objectives listed in section 1.2, the Commission should:

- be fully familiar with the Act and its associated Decisions and Instructions, the obligations these place on insurance companies, and the powers and obligations they confer on the Commission;
- operate, and be seen to operate, a firm but fair regulatory regime by enforcing legislative requirements in a consistent and transparent way: the message to the insurance industry and the public should be that the Insurance Commission is watching carefully and is likely to err on the side of caution rather than adopt a relaxed attitude, particularly towards insurance companies in difficulties;
- press for appropriate corporate governance arrangements, and insist that directors, actuaries and auditors of insurance companies take their responsibilities seriously;

- promote greater understanding of the insurance industry, e.g. through improved disclosure requirements pre, at and post sale of contract, press releases or public announcements, etc;
- act proportionately, having regard to the impact of its supervision on competition and innovation and Jordan's economy;
- target its resources as efficiently as possible, adopting a risk based approach to its supervision;
- seek to be proactive where possible and appropriate, including proposing such changes to the Act and its associated Decisions and Instructions as are considered necessary at any time taking into account the prevailing circumstances;
- where appropriate, make use of external experts, e.g. actuaries, accountants, auditors, IT consultants, etc.

Failure by the Insurance Commission to act in these ways, or to achieve its regulatory objectives, might reasonably be indicated or measured by:

- significant insurance company failures and/or losses for policyholders;
- incidences of fraud, money laundering or other financial crime;
- significant mismanagement or misconduct;
- significant market abuse or malfunction;
- widespread financial illiteracy or inadequate public understanding of particular products or services;
- successful litigation against the Commission on grounds of inconsistency or failure to meet its obligations under the Act.

#### **1.4 General guidance in dealing with insurance companies**

The Commission should always regulate insurance companies within the powers conferred on it by the Act, and should ensure that, before exercising any functions, sufficient grounds exist for doing so.

The aim should be to intervene promptly in an insurance company's affairs when, and only when, action is appropriate, having made full and suitable use of all available data in arriving at a judgement of that company's position. Action should be based on a sound understanding of the underlying issues.

Care should be taken to reserve the Insurance Commission's position when writing to an insurance company for more information etc, in order to avoid giving a false impression that further action will not be taken.

All letters to insurance companies relating to non-compliance with the Act should cite the relevant sections of the Act or its associated Decisions or Instructions, whether the letter is formal or not.



Where policy considerations are involved, it is important that Commission staff should talk to each other. Expertise or past experience relating to the issue in question may exist elsewhere in the Commission, which consultation will reveal.

It is recommended best practice for the Commission to establish a **precedents register**. This will help facilitate consistency and minimise duplication of research. Past cases of a similar nature could provide a useful guide for the current issue, or avoid the need to seek external advice. For example, past fit and proper cases might serve as an aid to current fitness considerations.

For the precedents register to be effective, it will need to include advice given by independent actuaries, lawyers, auditors, etc in the past. There is also a need to be careful, however, with each case being considered on its own merits. Emphasis should therefore be placed on decisions and/or actions likely to have general application. However, this should not rule out cases that, though unlikely to be encountered routinely, address important or fundamental regulatory issues, particularly where these break new ground or provide clarification.

### **1.5 Legal advice**

It is recommended best practice for the Commission to consider requesting legal advice in the following circumstances:

- to interpret the Act and its associated Decisions and Instructions with regard to their application to particular individuals or insurance companies upon winding up or other intervention, or in civil or criminal legal proceedings;
- to participate in meetings with particular individuals or insurance companies, notably in relation to applications for a licence, fit and proper cases and in the hearing of representations;
- to advise on the legal implications of policy changes;
- to advise on the drafting of new Decisions or Instructions;
- to advise on proposals by other Jordanian government departments having a bearing on insurance matters;
- when advised to do so by external experts.

The Commission can reasonably expect such legal advice to provide:

- specialist knowledge of the Act and its associated Decisions and Instructions;
- general knowledge of related fields of law, notably relating to companies in general, other financial services companies;
- an appreciation of developments within the Commission;
- reasonable familiarity with corporate practice.

The Commission should bear in mind that it is likely that requests for legal advice will take a long time to process due to their requiring considerable research, consultation and

reflection, and take this into account when considering the timing, formulation and quantity of references.

When seeking legal advice, the Commission should briefly outline the background to its concern, and specifically identify the legal issue on which advice is sought. It should describe relevant past practice and provide details of any relevant legal advice given previously. It should provide sufficient background information and other relevant documentation to facilitate a view being taken. It should also advise of its view on any policy implications of questions being raised. Where advice on the same issue has been requested from other external experts, this should be cross-referenced where appropriate.

Having obtained legal advice, it is essential that any views expressed by the Commission to insurance companies accurately reflect that advice.

It is recommended best practice for the Commission to post legal advice that could be useful in future cases to the precedents register.

## **1.6 Advice from External Actuarial Advisors**

### **1.6.1 General**

The Insurance Commission is under no obligation under the Act to consult external actuarial advisors on any issue. It could potentially be open to criticism, however, if failure to consult such advisors on an actuarial issue contributed to a supervisory error.

The quality of any advice sought from independent actuarial advisors on any issue is likely to be compromised if they are not aware of the background and all relevant circumstances of the case. It is therefore important that the Commission keeps its advisors fully informed of all developments relevant to the issue on which advice is to be sought.

It is recommended best practice for the Commission to post advice from external actuarial advisors that could be useful in future cases to the precedents register, and, where such advice could have legal implications, to make this the subject of legal advice.

### **1.6.2 General business**

It is recommended best practice for the Commission to consider requesting advice from independent actuarial advisors in relation to general insurance companies in the following circumstances:

- to advise on policy matters, including those relating to the Act and its associated Decisions and Instructions, and such questions as the definition of insurance;
- to provide information on the insurance industry and its practices generally;
- to advise on the interpretation of technical parts of the Act relevant to general insurance companies;
- to analyse an individual insurance company, including such matters as its general financial position; the risks to which it is exposed; the strength of its technical provisions; the suitability of its assets; the suitability of its group structure and

financing arrangements; and the effect of any proposed accounting or other concessions;

- to assist in meetings with an insurance company (by speaker phone, video-conferencing or, where practicable, in person), especially where that company brings its own actuary;
- to advise on the viability of a business plan submitted by a prospective insurance company as part of its application for a licence, or by an existing insurance company upon a change of control, e.g. with reference to the capital needed to support a given premium volume; the premium volume supported by a given level of free assets; or the suitability of its reinsurance programme;
- when advised to do so by legal experts.

Examples of specific circumstances in which advice from external actuarial experts is particularly likely to be sought include:

- in relation to an insurance company on which advice has been sought before;
- where an opinion is required on the adequacy of technical provisions held by an insurance company either as a whole or for a specific class or classes of business, for example, but not restricted to, where:
  - solvency outputs show conflicting results for reasons that are unclear, or show under-provisions the reality of which is doubted;
  - the company has supplied data additional to that in its returns, which the Commission wants analysed;
  - the company has provided an actuarial report which the Commission wants reviewed to explain technical terms; draw attention to caveats or omissions; or clarify the significance of conclusions;
  - the company has explained its reserving methods and the Commission wishes to know how appropriate and effective these are likely to be with regard to the types of business analysed;
- where an insurance company has raised a novel issue or an unusual argument and the Commission is seeking advice from a number of sources;
- where an actuarial perspective is needed on a piece of proposed legislation or change in supervisory practice.

The Commission can reasonably expect such advice to provide:

- knowledge and understanding of insurance industry practice;
- knowledge and understanding of investment principles;
- knowledge and understanding of the various statistical and actuarial techniques used for estimating general business liabilities;
- the skill and judgement needed to interpret the data and analyses available.

When seeking advice from independent actuarial advisors, the Commission should explain its concern, and state any specific issue that requires investigation. It should also indicate the degree of priority to be attached to the request. The request would normally need to be accompanied by the following items as a minimum:

- the company's returns and accounts for each of the periods in question and the previous two years;
- a copy of any analysis already undertaken by the Commission;
- any actuarial reports provided by the company in the last three years;
- confirmation of any concessions currently enjoyed by the company;
- copies of all relevant correspondence, and any other information considered relevant or requested.

Having obtained advice, it is important that the Commission request any clarification of this if necessary. This will help future advice to be pitched at the right level, and also prevent any incorrect interpretation of the advice being passed on to the company by the Commission. Where the actuarial advisors recommend that complex questions are put to the company, it is advisable that the Insurance Commission checks with the advisors that any minor changes it has made have not altered the sense of the question. Any letter sent to the company by the Commission should be copied to the actuarial advisors. The Commission may wish to consider the possibility of allowing direct correspondence between the independent actuarial advisors and the company in particularly complex cases.

It is recommended best practice that all references to independent actuarial advisors are logged. This will facilitate monitoring of turn round time, and also suggest companies that might need to be made the subject of more routine or ongoing reference to independent actuarial advisors.

### 1.6.3 Life business

It is recommended best practice that the Insurance Commission refer the following items in relation to life insurance companies to independent actuarial advisors:

- detailed scrutiny of the annual returns of every life insurance company to appraise its solvency position (both current and likely future), reserving basis, operational performance and other matters;
- policy matters, including those relating to the Act and its associated Decisions and Instructions, and such questions as the definition of insurance;
- providing information on the insurance industry and its practices generally;
- interpretation of technical parts of the Act relevant to life insurance companies;
- applications from prospective insurance companies for a licence;
- transfers of business or other insurance company or group restructurings;
- changes to an insurance company's Actuary;

- applications for concessions;
- participation in meetings with an insurance company (by speaker phone, video conferencing or, where practicable, in person), especially where that company brings its Actuary;
- resolution of other issues relating to the finances of life insurance companies and/or policyholders' reasonable expectations;
- any when advised to do so by legal experts.

The Commission can reasonably expect such advice to provide:

- knowledge and understanding of insurance industry practice;
- knowledge and understanding of investment principles;
- knowledge and understanding of the various actuarial methodologies used for estimating life business liabilities;
- the skill and judgement needed to assess the financial strength of the insurance company and its viability in the short and longer term, and to recommend appropriate regulatory responses to any issues of concern identified.

When specific advice is being sought from independent actuarial advisors, the Commission should explain its concern and state the issue that requires investigation. It should also indicate the degree of priority to be attached to the request. The request should be accompanied by all relevant correspondence and any other information considered relevant or requested.

Having obtained advice, it is important that the Commission request any clarification of this if necessary. This will help future advice to be pitched at the right level, and also prevent any incorrect interpretation of the advice being passed on to the company by the Commission. Where the independent actuarial advisors recommend that complex questions are put to the company, it is advisable that the Commission checks with the advisors that any minor changes it has made have not altered the sense of the question. Any letter sent to the company by the Commission should be copied to the advisors. The Commission may wish to consider the possibility of allowing direct correspondence between the actuarial advisors and the company in particularly complex cases.

It is recommended best practice that all references to independent actuarial advisors are logged. This will facilitate monitoring of turn round time.

### **1.7 Sharing information with other regulators**

It may at time be useful for the Insurance Commission to cooperate with foreign regulators charged with carrying out analogous functions, and to exchange with them the necessary information for the carrying out of those functions.

This is subject to disclosed information being subject to guarantees of compliance with professional secrecy. Such information is of a confidential nature, and must not be disclosed to third parties without the express consent of the Insurance Commission.

**Comment [d3]:** There is a lot of duplication in sections 1.6.2 and 1.6.3—it may be useful to combine them and specify those few items that appear to apply only to Life or General business.

## 2 VALUATION OF ASSETS AND LIABILITIES

### 2.1 Statutory requirements

The Insurance Regulatory Act 1999 and related Instructions and Decisions control the activity of insurance in Jordan. As part of the project providing advice to the Commission, GAD has recommended certain changes to this legislation to improve the regulation of insurance from an actuarial point of view. Where the Commission has indicated that it accepts these recommendations, it is assumed that the changes will be brought into force in due course. This manual is therefore based on the law as it is expected to be shortly.

The table below indicates the main sections of the law or proposed laws that are relevant for actuarial supervision of insurers.

Reference	Brief description
<b>Insurance regulatory act 1999</b>	
Article 23	Power for the Commission to issue instructions in a number of areas including solvency, the calculation of technical provisions, reinsurance, investment, location of assets, accounting policies and the conditions for establishing subsidiaries.
Article 25	Control over who can carry on insurance business.
Article 25(C)	Power to set minimum capital requirements
Article 33	Management to have the necessary, competence and experience.
Article 34A	Changes in control of the insurer.
Article 35	Provides for <i>Instructions</i> on the maintenance of Solvency Margin, Minimum Guarantee Fund, Technical Provisions and localisation of assets.
Article 38	Company to submit correct returns to the Commission. Dividends restricted to those shown in the returns. Company to inform the Commission if the company has financial or administrative difficulties.
Article 41	Grounds for the Director General to intervene.
Article 46	Reinsurance to be with a licensed reinsurer
Article 47	Grounds for the Director General to suspend a licence.
Article 101	“provisions of this Act shall be applied” to a reinsurer “in as much as they are applicable” and provides for a <i>Decision</i> to be issued on this
<b>Regulation No. (73) of 2005</b>	

Articles 3-4	Companies existing before Act came into force required to have minimum capital of: <ul style="list-style-type: none"> <li>• for life assurance, JD 4 million</li> <li>• for general insurance, JD 4 million</li> <li>•</li> <li>• Time period to comply: Dec 31, 2006 for life or general insurers; until Dec 31, 2007 for composite insurers.</li> </ul>
Articles 5-7	Minimum capital for company licensed after the Act comes into force: <ul style="list-style-type: none"> <li>• for reinsurance, JD 100million</li> <li>• for life assurance, JD8 million</li> <li>• for GB, JD 8 million</li> </ul>
<b>Instruction 2001 (4) on International Accounting Standards</b>	
Article 2	Insurer shall implement IAS
Article 4	But <b>Regulations</b> and <b>Instructions</b> take precedence if any conflict
<b>Instruction 2002 (2) on Basis of Calculating Technical Provisions</b>	
Article 2	Defines UPR, URR, Reported Claims, IBNR, O/S Claims, (life assurance) Mathematical Provision and Catastrophe Provisions
Article 3	Company has to maintain TP's only at the end of each financial year
Article 4	For GB, require UPR, URR, RC, IBNR and Cat
Article 5	For life, require Mathematical Provision, UPR, RC
Article 7	7A – UPR for GB calculated on days remaining except M&T where it “shall be calculated on the basis of written premiums”; UPR for life “shall be calculated in accordance with the experience of the Company”; 7B – Reported Claims calculated for each claim separately; 7C – URR, IBNR and Cat Prov “in accordance with the experience of the company and the estimations made by it”; 7D – Mathematical Provision “in accordance with the actuarial methods”

Article 8 to 10	O/S Claims and UPR may be net of reinsurer's share (subject to Reinsurance Instructions); but net OSCR may not be less than 10% of gross (or 5% for Fire and other property)
Article 11	No discounting of O/s Claims Reserve
Article 12	Annual certificate required from Actuary of all TP's and their adequacy; Similar semi-annual certificate required for the "financial year following the year these Instructions came into force" ie 2003 only; DG can ask Actuary for "clarification" of any info or data in the certificate
<b>Instruction 2002 (3) on Solvency Margin</b>	
Article 4	The Solvency Margin equals the ratio of Capital Available (CA) to Capital Required (CR); the Minimum Solvency Margin must be at least 150%.
Article 5	CA consists of Core Capital (CC) and Supplementary Capital (SC); SC is limited to 50% of CC
Article 6	CR is defined in 4 categories – asset risks; policy liabilities; reinsurance ceded and life assurance risks.
Article 7	SM calculations to be submitted quarterly, with annual and semi-annual calculations certified by Auditor; separately for business in Jordan; business in Jordan and branches outside Jordan; business in Jordan and outside branches and subsidiaries
<b>Decision 2002 (5) Guidelines on Solvency Margin</b>	
re Annex(2)	"Deficit in provisions and technical provisions" means shortfall in "doubtful debt" against either Auditor's report or IC on-site visit plus shortfall in TP's against either Actuary's report or IC on-site visit; Subordinated loan must not be "pledged" and must be at least 5 years term (although o/s term may be less)



re Annex(3)	<p>Asset values to which factors are applied should be after deduction of doubtful debts and should exclude amounts guaranteed by Jordanian government and 50% of amounts guaranteed by banks;</p> <p>o/s premiums for life business should also be excluded provided the Actuary has taken them into account for the Mathematical Provision; otherwise based on book value as in financial statements;</p> <p>Reinsurers are rated into 4 groups, based on best of 3 ratings; group 1 reinsurers' share of TP's attract 0.5%/2.0% capital req't as stated in Annex 2; risks of reinsurers in groups 2 to 4 covered in Annex (5); Banks, bonds and debentures are rated into group 1 and 2 – not clear if also based on best of 3;</p>
re Annex(4)	Capital required on GB policy liabilities based on net O/s claims provision (reported and not reported) and net UPR (or 50% of net written premiums if greater)
re Annex(6)	"... life policy loans shall be deducted from the Mathematical Provisions if the granted loan represents the maximum of 100% of the value of the life policy"
<b>Decision 2003 (1) on Compliance with Solvency Margin</b>	
Article 1	Companies must comply with Article 4B of SM Instructions No 3 of 2002 "as of" end 2003 (i.e., 150% of Capital Required)
Article 2	If company met minimum SM at 31/12/2002, must maintain it. If not, must provide within 30 days a work plan with time schedule for complying by end 2003.
<b>Instruction 2002 (4) on Reinsurance</b>	
Article 5	At least 75% of total reinsurance must be with group 1 or 2 reinsurers, at most 25% with group 3 or group 4
Article 6	Company must ensure any group 3 or 4 reinsurer meets Jordan SM requirement and supply certain information to the Commission

<b>Instruction 2003 (2) on Financial Reports and Statements</b>	
Article 3	Accounting policies prescribed
Article 4	Forms and notes to be submitted semi-annually; annual statements to be audited and certified by Auditor; semi-annual to be “reviewed” by Auditor; Separate returns for business in Jordan; all business including branches outside Jordan; and all business including subsidiaries [ie consolidated accounts]
Article 5	Separate (but similar) sets of forms for life, GB, composite and Islamic companies
<b>Decision 2003 (2) on Financial Reports and Statements</b>	
Article 1	Specifies quarterly forms for supervisory purposes; to be signed by Auditor as consistent with records of the company.  A schedule specifies the various forms required for each quarter; for life, GB, composite and Islamic companies; and for business in Jordan / all business including branches outside Jordan / all business including subsidiaries

**Comment [d4]:** Should Decision 5 of 2004 (Property Investment Valuation Decision) be cited here? No link to decision on web site.

Article 35 of the Law requires every Jordan insurance company to form adequate technical reserves for all its insurance business.

Instruction 2002 (2) sets out the basis for calculating technical provisions. Such technical reserves must, under Article 6, be formed separately for general and life class business. The composition of the technical reserves for general business is prescribed in Article 4. The composition of the technical reserves for life business is prescribed in Article 5. The method of calculation of the technical reserves for general business is prescribed in Article 7.

## 2.2 Overview

The rules relating to the valuation of assets and liabilities referenced in section 2.1 are very important, representing one of the cornerstones of Jordan’s system of prudential regulation for insurance companies.

Together, they require that the assets held by an insurance company must be at least as great as the reserves for its business in force, both calculated in a specified way, and the solvency margin. This is one of the key means by which protection for policyholders is achieved. The rules also provide the basis for effective monitoring of an insurance company’s solvency position by the Commission, and for the objective comparison of one insurance company with another.

**Comment [d5]:** Law says “shall maintain”; does that mean continuously? Instructions say technical provisions must be maintained “at the end of each financial year” but law says “as estimated at the end of the year.” It looks as though the Instruction has misstated the legal obligation by shifting the order of words (where “estimated” appears).

The Commission does not have the primary responsibility for ensuring compliance with these rules. This rests instead with the directors of the insurance company and, with respect to the calculation of the technical provisions, with its Actuary. It does, however, have a role in **monitoring compliance** with the rules.

The primary responsibility for monitoring compliance with the asset valuation rules rests with the insurance company's auditors. The Commission may reasonably place reliance on the auditors in this regard as, unlike them, it does not have access to the necessary assets data to check compliance. However, the Commission should nonetheless be on the look out for apparent clear breaches of the rules, and for this reason and more generally, it is important that Commission staff have a sound general understanding of the rules.

A similar position exists with respect to the liability valuation rules as they relate to general business. However, in this case, the Commission should, in theory, have access to data sufficient to enable it to check the reasonableness of the reserves held for such business, and should ideally seek to do so. Some techniques that might be used for this purpose are outlined in section 5 of this manual, which require a sound general understanding of the rules.

The liability valuation rules as they relate to life business may need an actuary to advise on whether the valuation basis adopted by a company is within the rules. It is not clear at this stage whether the necessary resources for this will be available to the Commission. However, in any event, the Commission should seek to have a sound general understanding of the rules. This is because where an (external) actuary advises that the valuation does not meet the requirements of the rules, responsibility for requiring the company to take corrective action rests with the Commission, and also because it will allow the Commission to question and monitor the advice it receives.

The remainder of this section of the manual provides brief synopses of the asset and liability valuation rules. These are not intended to be, and should not be taken as, full summaries of the rules. Commission staff should refer to the rules themselves, and in the case of the asset valuation rules, any associated guidance that may be issued to companies. Guidance on how to monitor compliance with the rules based on information in the returns is provided in sections 5 and 6 of this manual.

### **2.3 Liability valuation rules for general business**

The liability valuation rules for general business are contained in Instruction 2002 (2) on Basis of Calculating Technical Provisions. These cover the constituents of the technical provisions for general business, namely:

- unearned premium provision;
- unexpired risk provision;
- reported claims provision;
- incurred but not reported provision;
- outstanding claims provision (the sum of the reported claims and incurred but not reported claims provisions);

- catastrophe risk provision;

and are described in the following subsections. These provisions must be held for each general insurance class for which the company has a licence.

Further information on these provisions, including guidance on how to assess the adequacy of those established by an individual insurance company, is provided in section 5 of this manual.

### 2.3.1 General requirement

All liabilities for general business are to be valued according to generally accepted accounting principles. In determining the amount of these liabilities, all contingent and prospective liabilities should be taken into account. The amount of the technical provisions must be certified by the company's actuary annually. The technical provisions for general business must be separated from those for life business.

The liabilities should be determined gross of reinsurance, with the reinsurers' share of technical provisions calculated separately. The reinsurers' share of technical provisions is deducted from the gross technical provisions so that the net liability is included on the liability side of the balance sheet. The net of reinsurance technical provisions must not be less than 10% of the gross technical provisions, except for fire and other property damage where they must not be less than 5% of the gross technical provisions.

The preferred basis of accounting to be used is one-year accident year accounting (i.e. based on the risk earned during the financial year). ~~This does not appear to be mentioned in the law at present.~~

### 2.3.2 Unearned premium provision

This provision must be calculated separately for each contract, using the 365ths method, except for marine and transport insurance where the unearned premium should be the written premium for any risks that have not expired; see Article (7) section A-1 of the (Basis of Calculating the Technical Provisions Instructions of 2002)

Under the 365ths method, earned and unearned premiums are calculated on a strict day-by-day apportionment, based on the last premium payment date and the risk period covered by that premium.

Regarding marine and transport insurance, Decision 15 of 2005 further provides that if the company is unable to know whether an insurance policy is valid or not, policies underwritten during the last three months prior to the date of calculating the unearned premiums reserve shall be considered valid.

For annual policies where the insurer has agreed to accept the premiums in instalments (monthly for instance), the written premium should be the whole of the premium due under the policy for the year and the unearned premiums and outstanding premiums should correspond to this.

The unearned premium provision should be based on the gross premiums payable, without any deduction for commission, policy fees or other acquisition costs despite the

fact that deferred acquisition costs for general business are not allowed to be included as an asset.

#### 2.3.3 Unexpired risk provision

This provision is calculated as the amount, if any, by which the total amount of claims and expenses expected to arise after the valuation date from contracts in force at that date exceeds the aggregate of the unearned premium provision and any premiums expected to be paid under those contracts after the valuation date; see Article (2) section B and Article (7) section C of the (Basis of Calculating the Technical Provisions Instructions of 2002)

#### 2.3.4 Reported claims provision and incurred but not reported provision

The reported claims provision should be calculated separately for each claim, on the basis of costs still anticipated.

The provision for claims incurred but not reported (IBNR) must also be calculated. The method used to calculate this provision should take into account the company's past experience as to the number and magnitude of late reported claims.

Both provisions (which collectively make up the outstanding claims provision) should also include an allowance for claims settlement costs in respect of outstanding claims. All such costs should be allowed for, whether they are expected to occur directly or indirectly, through the employment of the company's own staff or otherwise.

Any recoverable amounts arising out of subrogation or salvage should be estimated on a prudent basis, and included in the gross outstanding claims provision. The total amount in respect of salvage and subrogation is then deducted from the gross OCP to show the net provision. Where such amounts are material, details should be disclosed in a supplementary note in the returns. For this purpose, a deduction of more than 5% of the provision before deduction would normally be regarded as material, unless the absolute amount of the deduction, in the context of the company's financial results for general business, is immaterial.

No allowance for future investment income is permitted when calculating the amount of the provision, and any form of discounting or deductions, whether implicit or explicit, is also prohibited; see Article (2) B, and Article (7) section B and C, of the (Basis of Calculating the Technical Provisions Instructions of 2002).

2.3.5 Catastrophe risk provision

[The following text in blue is a GAD comment.] There is a requirement according to Section B of Article(2) of the (Basis of calculating the Technical Provisions of 2002) to maintain this provision to meet the losses that may result from catastrophic events arising from uncommon risks or risks the repetition of which can not be statistically determined such as natural catastrophes.

There exist complex models for estimating the likelihood of catastrophic events occurring. However these are likely to represent an over-sophistication, as it is in the nature of such provisions that a very wide range of results may be justified.

Prudential management of an insurance company will include the purchase of catastrophe reinsurance protections, to protect against any reasonable foreseeable events.

It should be possible to estimate a suitable catastrophic risk provision from the cost of the reinsurance protection, and any alternative quotations that were received when the catastrophe protections were renewed.

2.3.6 Other technical provisions

Although the law makes no specific mention of other technical provisions, where they are necessary any such provisions held must be included in those reported in the returns.

2.4 **Liability valuation rules for life business**

The liability valuation rules for life business are contained in Instructions No. (2) of 2002 Basis of Calculating the Technical Provisions Instructions.

- 2.4.1 Mathematical Provision [insert description of calculations, key issues]
- 2.4.2 Unearned Premiums Provision [insert description of calculations, key issues]
- 2.4.3 Reported Claims Provision [insert description of calculations, key issues]

**Comment [d6]:** Note: all of section 2.4 is based on instructions that were never issued. Therefore this section should be replaced with one that parallels the general business rules in 2.3, e.g., a description of aspects of each of the technical provisions specified for life business: Mathematical Provision, Unearned Premiums Provision, Reported Claims Provision.

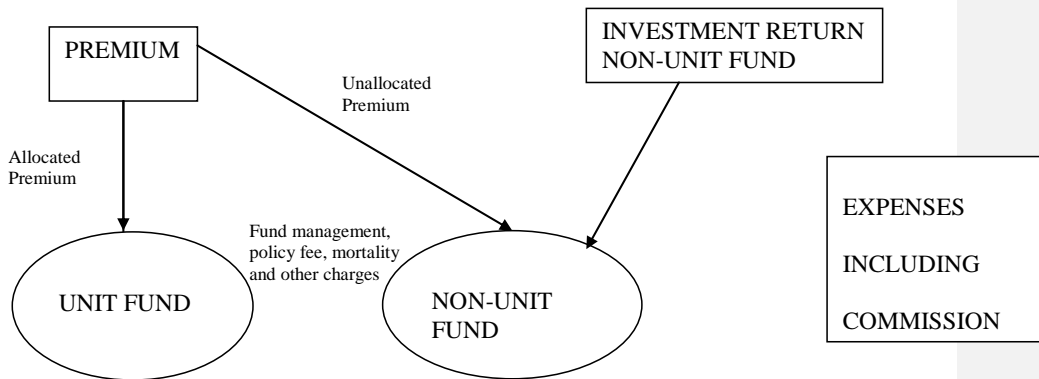


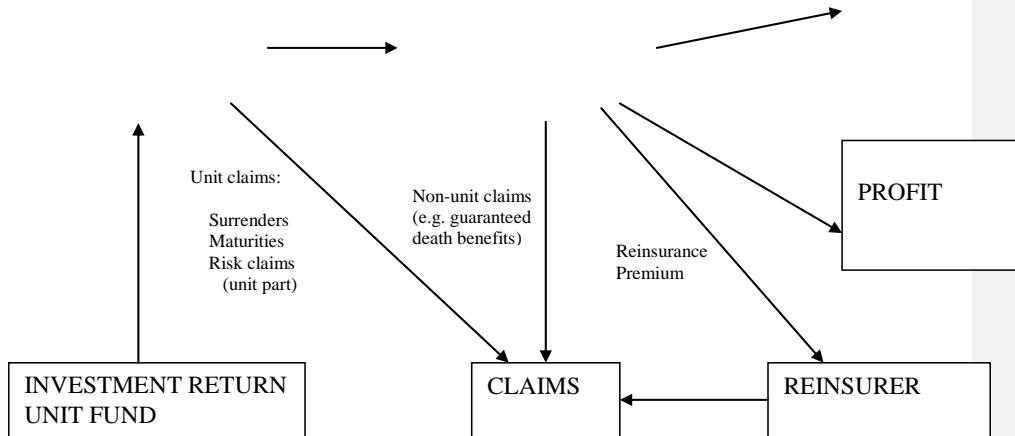
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2.4.3.1 Summary of structure and cash flows

**Comment [d7]:** Retain this or is it tied to the non-issued instructions?

The figure below summarises the overall structure of, and cash flows associated with, an investment-linked contract.





## 2.5 Provision for adverse deviations

In some jurisdictions, provisions for adverse deviations are built into many of the valuation factors used to determine the technical provisions held in respect of both general business and life business.

In others, such as Canada, explicit Provisions for Adverse Deviations must be held.

In Jordan there are no provisions for adverse deviations built into the general insurance technical provisions.

However the general requirement to hold a solvency margin of 150% of the capital requirement represents a global provision for adverse deviations.

**Comment [d8]:** Need to confirm this; likely reference to the non-issued 2004 instructions. Instruction 2 of 2002 only says that the mathematical provision should be calculated in accordance with actuarial methods.

## 2.6 Asset valuation rules

This manual is not intended to provide a commentary on the detailed IAS requirements, but it may be useful to set out briefly how IAS asset valuations are determined.

### 2.6.1 IAS Asset Valuations

Financial or invested assets are broadly split into four categories:

- Financial Assets Held for Trading
- Available for Sale Financial Assets
- Held to Maturity Investments

- Other assets for which specific rules are in place, e.g. property, subsidiaries or associates

The concept that applies to most asset valuations is one of “Fair Value”. This represents a reasonable market value less the costs of selling, but assuming that it is a normal sale, not a distressed sale.

#### *2.6.1.1 Financial Assets Held for Trading*

Fair value is used for all assets classed as Held for Trading.

Normally the asset valuation values will be the same as the Fair Values.

#### *2.6.1.2 Available for Sale Financial Assets*

Fair value is used for all assets classed as Available for Sale.

Normally the asset valuation values will be the same as the Fair Values, with the exception noted above in 2.6.1.1.

#### *2.6.1.3 Held to Maturity Investments*

The IAS rules stipulate that assets classed as Held to Maturity must be valued using the amortised book value.

If market interest rates have changed significantly from the rates applicable at the point the asset was purchased then there could be considerable differences between the IAS asset values on this basis, and the asset valuation basis. The variation is also likely to be greater the longer the outstanding term of the asset.

It may help to clarify how this operates by giving a numerical example.

Suppose an insurance company buys a zero coupon bond at 31 December 2004 when interest rates are 5%.

If the bond is of 3 year duration and the maturity value is 100, then, ignoring dealing costs, the price and book value of the bond is 86.38. This is the value on both the asset valuation rules basis and IAS basis.

A year later, at 31 December 2005, the value on an amortised book basis is 90.70. This value is fixed from the point that the bond is purchased.

The value of the bond on an asset valuation rules basis will depend on market interest rates as at 31 December 2005. If these have decreased to 3% then the bond will be valued at 94.26. If the market interest rates have increased to 7%, then the bond will be valued at 87.34.

#### *2.6.1.4. Other Assets*

In general other assets are valued at “Fair Value”. There can be significant differences between these value and asset valuation values, for example when considering fixed assets.



### 3 SOLVENCY MARGINS

#### 3.1 Statutory requirements

Paragraph (A) of Article (35) of the (Insurance Regulatory Act of 1999) requires every insurance company operating in Jordan to maintain an adequate solvency margin in respect of the whole of its business. The solvency margin represents the assets (excluding any intangible assets) of an insurance company in excess of its liabilities. Note that there are no explicit rules concerning minimum guarantee funds in Jordan, despite reference to them in Article 35(A). However, the Commission does have powers under Article 41 if accumulated losses for the insurer exceed 50% of its paid up capital.

The solvency margin is the ratio of the Capital Available to the Capital Required and this must not be less than 150%. The composition of the Capital Available and the method of calculation of the Capital Required are prescribed in the annexes to the (Solvency Margin Instructions No. 3 of 2002).

The Capital Required is determined using a risk based approach which attempts to set the solvency margin required for each insurer having regard to the riskiness of its operations as indicated by relevant factors such as the amount and type of its assets, the amount and type of premiums and reserves, the amount of reinsurance and the status of the reinsurers etc.

Article (7) of the (Solvency Margin Instructions of 2002) require the preparation, for each quarter, of a statement of the Solvency Margin the end of that quarter.

#### 3.2 Overview

The solvency margin requirements referenced in section 3.1 are an important part of Jordan's system of prudential regulation for insurance companies.

They provide for an improved level of protection for policyholders above that already provided by the asset and liability valuation rules discussed in section 2 of this manual by requiring that assets must exceed liabilities by a specified amount. Taken together with the valuation rules, they also provide a means by which an insurance company's solvency position can be monitored effectively, and objective comparisons of one insurance company with another made, by the Insurance Commission.

The responsibility for calculating the Solvency Margin and for ensuring that cover for the Solvency Margin is maintained rests with the directors of the insurance company. However, the Insurance Commission has the responsibility to **monitor** the level of cover for the Solvency Margin reported by an insurance company – which is the single most important indicator of its financial strength – and consider what, if any, regulatory action it needs to take in response. In doing so, it should also check the calculation of the Solvency Margin for any apparent errors. For these reasons, it is important that the Insurance Commission has a sound understanding of this calculation.

The remainder of this section of the manual provides details of the Solvency Margin calculation, including the principles that underlie it, the items that are, or may be, permitted as cover for the Solvency Margin and related matters. Guidance on how to

check the Solvency Margin calculation in the returns is provided in section 7.6 of this manual.

### 3.3 Capital Available

Annex (2) shows the calculation of the total Capital Available.

The operation of the Capital Available calculation, and of the form are described in detail in Chapter 4.3 of the Guidance for companies

### 3.4 Capital Required for Asset Risks

Additional capital is held in respect of the assets of the company. This is because there is market risk that the market (or fair) value of the assets may change and credit risk that expected payments may not be received due to defaults.

Investment-linked assets are excluded when calculating the capital required for asset risks. This is because the policyholder bears the market and credit risks for these assets not the company.

Annex (3) shows the format of the return and the Factors to be used to calculate the Capital Required for Asset Risks.

The asset values to be used in the calculation should be consistent with the admissible asset values shown in Form 31A and 31B.

The capital required in respect of Bonds and Bank accounts is dependent on the international ratings. According to Section D of Annex (3) to the Guidelines for the Solvency Margin Instructions of 2002 (Decision 5 of 2002) the following are to be adopted:

	<b>Rating</b>
Standard & Poor's	A
Moody's	A
Fitch Ibc	B

[Following text in blue is a GAD comment.] This appears to be based on an out of date reading of the Fitch rating system, and we would expect the equivalent rating classification to be "A" for each.

There is no statement in the Decision of which rating to use where a bank or security has more than one. However Section C of Annex(3) to the (Guidelines for the Solvency Margin Instructions of 2002) referring to reinsurers ratings states that the highest should be used, so there may be an implication that the highest should be adopted.

All the rating agencies have A- ratings as well as A, and it would normally be considered that the larger gap is between A- and BBB+ (on S&P).

All linked assets, where the asset risk is borne by the policyholder, are excluded from the computation.

#### 3.4.1 Cash and deposits of up to 1 month

The capital required factors are:

	Factor
Cash in Hand, Monthly Deposits and Certificates of Deposit	0%
Accrued Revenues	2%
Prepaid Expenses	0%

*Cash in Hand* are physical notes (and coins) held by the insurance company.

*Monthly Deposits* are cash or call bank accounts, and deposits due in less than one month. Unlike longer term deposits there is no additional capital requirement for lower rated banks.

*Certificates of Deposit (CD's)* are securitised bank deposits, normally of short duration, which means that it possible to sell them to another investor. For this reason they can be regarded as equivalent to cash, whatever their outstanding term. If there is not a liquid market for the CD's held, and they are in practice being held to maturity then they should be treated as any other bank deposit.

*Accrued Revenues* represent accrued interest on bonds and loans. Whilst the capital value of the assets attracts factors varying from 0% to 25%, it is reasonable to use a single factor of 2% for any accrued income as this amount will normally be small.

*Prepaid expenses* represent any bills that the company has paid at the accounting date, but where the payment has not yet been debited from its bank account. This item should be small.

#### 3.4.2 Accounts Receivable

To the extent that these assets are admissible, the value of the assets should be the same as shown in Form (9) of the Composite Returns. Doubtful debts should already have been deducted in Form (9). In addition, receivables from the Jordanian government and receivables guaranteed by it should be excluded from the calculation. 50% of receivables guaranteed by banks should also be excluded from the calculations (see section A of the Second part of the Guidelines for the Solvency Margin Instructions of 2002).

The factors depend on the date when the debt was due to be paid:

	Factor
Not yet due	10%
Overdue less than 90 days	20%

Overdue 90 to 180 days	50%
Overdue 180 to 360 days	75%
Overdue more than 360 days	100%

*Policyholders* accounts receivable should consist of premiums due only.

*Agents or Broker* accounts receivable can arise from unsecured business development loans, commission advances, or premiums retained before being passed to the insurance company.

*Subsidiaries or Associates* may owe the insurance company premiums for their own risks, or it is possible that services may be provided by one organisation to another. Where services are provided, a detailed management agreement should be produced, with a copy supplied to the Insurance Commission to ensure equitable treatment of each organisation.

*Shareholders* may have accounts receivable if the company is raising capital via a rights issue, or via partly paid shares. An additional example may occur for Islamic Companies which may have the right to raise additional funds from shareholders if sufficient losses are incurred.

*Employees* may borrow money from the company in favourable circumstances, as part of their employment package. Such loans need to be monitored carefully as it may be difficult to recover the amount if the employee leaves. *The company should, however, be able to deduct the amount of any statutory leaving service lump sum.* To the extent that any outstanding loan is less than a recoverable leaving service lump sum it is reasonable to treat the employee any loan as “not yet due”.

### 3.4.3 Reinsurers in Group One

Group One reinsurers (see 3.6) lead to the following Capital Requirements:

	<b>Factor</b>
Receivables from the Reinsurer	5%
Unexpired Premium Provision Reinsured	0.5%
Outstanding Claims Provision Reinsured	2%

All Group One reinsurers values are aggregated into single receivable, UPP and OCP figures.

Unlike Group Two and Three reinsurers, there is no offset for payments due to the reinsurer, or reserve/security deposits held.

Any receivables from local insurance companies also attract a 5% factor. Again it is not possible to offset amounts owing to local insurers.

#### 3.4.4 Other Recoverables

The assets included here are:

	<b>Factor</b>
Other recoverables on unpaid claims	15%
Receivable Notes and Post-dated Cheques – due in 6 months	10%
Receivable Notes and Post-dated Cheques – due in more than 6 months	25%

Other recoverables on unpaid claims consists of salvage and subrogation, that is whatever the Insurance company can get for the remains of the vehicle, for example, when it has paid a claim as a “total loss”. The factor here represents the estimation risk. Normally it will be a small amount in the accounts.

It is not entirely clear what is meant by a receivable note. If it is an undertaking by the insured to pay premiums by instalments then it is not clear how, in practice, it is distinguished from accounts receivable from policyholders. Setting up any general insurance contract would normally require the insured to undertake to pay the premiums, so that any debts from the insured could probably reasonably be defined as “Receivable Notes”

Post-dated cheques would also appear to be a form of payment of debts due, and would therefore not naturally differ from accounts receivable.

This ambiguity is the reason these items are generally seen as payment methods, and are not separately identified in international accounts.

#### 3.4.5 Bank Deposits of more than one month term

The Bank deposit factors are:

	<b>Factor</b>
Deposits of 1 month to 1 year - Banks A rated or better	0.5%
Deposits of 1 month to 1 year – Banks less than A rated	4%
Deposits of more than 1 year - Banks A rated or better	2%
Deposits of more than 1 year – Banks less than A rated	8%

The bank deposit factors are consistent with the factors used for bonds, reasonably enough as there is little practical difference where the bonds are not traded.

#### 3.4.6 Shares – Traded Securities or Available for Sale Securities

The factor for holdings in equity shares is 15%, whether these shares be classed as Trading securities or Available for Sale Securities.

The Admissible Asset rules restrict the holdings in listed shares to 5% of the business amount, and to 1% for unlisted shares.

#### 3.4.7 Bonds – Traded Securities, Available for Sale or Held to Maturity

The factors are:

	<b>Factor</b>
Bonds issued or guaranteed by the Jordanian government	0%
Bonds issued or guaranteed by a “AAA” government	0%
A or better rated Bonds held for Trading	0.5%
Less than A rated Bonds held for Trading	4%
Other Bonds due within 1 year, A rated or better	0.5%
Other Bonds due within 1 year, less than A rated	4%
Other Bonds due after 1 year, A rated or better	2%
Other Bonds due after 1 year, less than A rated	8%

There is a distinction between “AAA” rated government bonds and other bonds. Both S&P and Fitch use “AAA”, but there is no statement on which rating agency to use for the “AAA”.

It may be worth considering extending the range of acceptable government backed stock.

On Fitch, for instance, several EU countries, Japan and Canada are not AAA rated. As at June 2004 the Fitch AAA rated countries were Austria, Denmark, Finland, France, Germany, Ireland, Luxembourg, Netherlands, Norway, Singapore, Spain, Sweden, Switzerland, the UK and the USA.

Where the due date of any of the Bonds or the debentures is not known, they should be classified as due after one year. Where the rating of the Bonds and debentures, or the party issuing or granting such, is not known they should be classified within Group Two. The details of the Guarantee Value, Government guarantees and Bank Guarantees should be listed under notes of Item Annex No. (3).

#### 3.4.8 Investment in Real Estate

Any Investment in Real Estate has a factor of 15% to derive the capital required.

This is significantly more than the 8% required in respect of any Real Estate in the Fixed Assets.

An investment in real estate is any property or land directly owned by the company, but not used the company for the purpose of its business.

Property must be located in Jordan or in any Zone A country.  
Any directly held property held outside Jordan should be investigated.

#### 3.4.9 Investment in Subsidiaries or Associates

With respect to investments in financial subsidiaries and financial associates, there is no capital requirement, as they are excluded from capital available in Annex 2. However, investments in non-financial subsidiaries and non-financial associates are subject to a capital requirement, with a factor of 100% applied. (Annex 3, Solvency Margin Instructions No. 3 of 2002).

#### 3.4.10 Other Loans

The factors for other loans are:

	<b>Factor</b>
Life Policy Loans (not exceeding the surrender value)	0%
Life Policy Loans (exceeding the surrender value)	8%
Real estate collateralised loans (or mortgages)	8%
Other collateralised loans	12%
Other loans	25%
Loans for subsidiaries, associates and related parties	25%

Whilst life policy loans in excess of the surrender value are shown as having a factor of 8%, it should be noted that these assets are inadmissible.

#### 3.4.11 Other Investments

Other investments have a factor of 20%.

The Insurance Commission should obtain a full description of any holdings in collective investment funds, and in particular should determine where the fund is domiciled. Investments in Mutual Funds domiciled in the United States, and UCITS domiciled in the European Union may require less investigation than a collective investment fund located in an offshore jurisdiction.

#### 3.4.12 Fixed Assets and Other Assets

Property and Land has a factor of 8%.

Other fixed assets are effectively inadmissible.

### **3.5 Capital Required for Policy Liabilities**

The method of calculation of the Capital Required for Policy Liabilities is prescribed in Annex (4) of (Solvency Margin Instructions of 2002).

### 3.5.1 Overview

The calculation of the Capital Required for Policy Liabilities recognises three measures of exposure:

- Net premiums written;
- Net Unexpired Premium Provision (UPP);
- Net Outstanding Claims Provision (OCP);

where “net” is net of all reinsurance premiums, but does not exclude any acquisition costs. These measures are indicative of insurance risk and relate to the uncertainty in the setting of premium rates and the calculation of technical provisions.

These exposures are identified separately for each of the 8 General Insurance Licenses:

- Motor
- Marine & Transport
- Aviation
- Fire & Other Property Damages
- Liability
- Credit and Suretyship
- Medical
- Other General insurance classes

The Capital Required for Policy Liabilities is calculated as the **sum** of 16 separate amounts, broadly calculated as:

- A factor, separately defined for each General Insurance Licence, multiplied by the greater of 50% of the relevant net Written Premiums and the relevant net UPP, and
- A factor, separately defined for each General Insurance Licence, multiplied by the relevant net OCP.

The calculation is carried out at an aggregated level, across each of the General Insurance Licenses.

### 3.5.2 Premium Factors

The gross premiums written in the previous financial year must be adjusted by deducting any reinsurance premiums to determine the net written premiums.

The net written premiums should correspond to the net written premiums shown in Form (6).

The gross UPP's should be adjusted by deducting the reinsured UPP's to determine the net UPP.

The net UPP's should correspond to the net UPP's shown in Form (6) of the Returns

The factor applied to the premium result is 8% for all general insurance licenses.

### 3.5.3 Claims Factors



The Outstanding Claims Provision is adjusted by deducting any reinsured provision to determine the net OCP.

The net OCP's, by general insurance license, should correspond to the net OCP's shown in Form (7).

The factor applied to the net outstanding claims provisions are:

Motor	20%
Marine & Transport	10%
Aviation	20%
Fire & Other Property Damage	10%
Liability	25%
Credit and Suretyship	25%
Medical	20%
Other General Insurance Classes	15%

### 3.6 Capital Required for Reinsurance Ceded Risks

The calculations for reinsurers are to address the risk that the reinsurer may default on payments due to the insurer. The method for calculating capital required for reinsurance ceded risks is prescribed in Annex (5) of the Solvency Margin Instructions (No. 3, 2002).

Any reinsurance to **Group One reinsurers** leads to additional capital requirements under the Asset Risk section (see section 3.4.) and so is excluded from the calculations under Capital Required for Reinsurance Risks. The Capital Required for Reinsurance Risks applies to reinsurers that are in **Group Two** and **Group Three**, classified according to section C of the Second Decision in the (Guidelines for the Solvency Margin Instructions of 2002, Decision No. 5, 2002).

The Groups are defined as follows:

	<b>Standard &amp; Poor's</b>	<b>Moody's</b>	<b>AM Best ***</b>
Group One	AAA	Aaa	A++ & A+
	AA	Aa	A & A-
Group Two	A	A	B++ & B+
	BBB	Baa	B & B-
Group Three	BB	Ba	C++ & C+
	B	B	C & C-
Group Four	Less than above, or Not Rated		

\*\*\* To be adjusted

**Comment [d9]:** Is this rating scheme "to be adjusted"?

#### 3.6.1 Group Two and Three Reinsurers

The capital required for reinsurance risks is defined in Part I of Annex (5) as 30% for Group Two and 50% for Group Three of:

- Reinsurers UPP
- + Reinsurers OCP
- + 10% x (Reinsurers UPP + Reinsurers OCP)
- + Reinsurer Receivables
- Reinsurer Payable
- Deposits held as security

This formula encourages the payment of quarterly reinsurance premiums when the UPP will be offset by the “reinsurer payable” item.

The offsets may allow reinsurance arrangements with Group Two or Three reinsurers to be structured to reduce the Capital Required as far as possible.

The Insurance Commission should compare the capital required for each of Group Two or Three reinsurers and make sure it is? at least equal to the capital required under the formula for a Group One reinsurer (in section 3.4.3).

Where there are deposits held as security used to reduce the capital required, it is necessary to check that the deposits are genuinely under the control of the company. Deposits should be held with an Approved Financial Institution in the Kingdom. A Letter of Credit should not be regarded as equivalent to a deposit.

### 3.6.3 Group Four Reinsurers

The calculation of the relevant amount for Reinsurance to Group Four reinsurers is the same as for Groups Two and Three but rather than leading to a Capital Required, the relevant amount is deducted from the Capital Available in Annex (2).

**Comment [d10]:** This doesn't appear to be the case re deducting from capital available in Annex 2. The Guidelines for the Solvency Margin Instructions state that a factor of 100% is to be applied to Group Four reinsurers.

## 3.7 **Capital Required for Life Insurance Risks**

The method of calculation of the Capital Required for Life Insurance Risks is prescribed in Annex (6) of the (Solvency Margin Instructions (No. 3 of 2002). The Guidelines for the Solvency Margin Instruction (Decision No. 5 of 2002) further stipulate that the Capital Required is calculated by applying the factors shown in Annex (6) to both the Mathematical Provision and the Total Insured amounts detailed by individual or group policies.

Life policy loans shall be deducted from the Mathematical Provision if the granted loan represents the maximum of 100% of the value of the life policy.

### 3.7.1 Overview

The calculation of the Capital Required for Life Insurance Risks recognises the risk that the company faces as a result of the inadequacy of the Mathematical Provisions.

[Lawrie: believe we need to insert here an overview description of Annex 6 of the Solvency Margin Instructions—go through calculations as above for general business. This would replace deleted text based on instructions that were never issued (Solvency Margin Amendment Instructions)]

### 3.8 Capital Required for Interest Rate Risks

- .
- We [GAD] recommend that the Insurance Commission advise the market each year of the appropriate change in interest rates to adopt. .
- We [GAD] recommend that the Insurance Commission advise the market each year of the appropriate change in interest rates to adopt. .

**Comment [d11]:** Neither the Solvency Margin Instructions nor the Guidelines for the Solvency Margin Instructions mention Capital Required for Interest Rate Risks. This section was based on amended instructions (not issued), and so was deleted. Should anything replace it to address interest rate risks?

## 4 RISK ASSESSMENT AND SUPERVISORY PRACTICE

### 4.1 Introduction

Insurance is fundamentally about transfer of **risk**: from consumers, who wish to buy protection or save for themselves or others, to the insurance industry, which takes on the risk. The reinsurance industry (including Lloyd's) enables the insurance industry to spread the risks it has assumed, and to provide capacity for it to accept new risks.

The purpose of this section of the manual is to:

- describe the different types of risk borne (and presented) by insurance companies;
- discuss what the regulatory response to these risks should be, including making recommendations for the approach and procedures that the Insurance Commission should adopt to seek to assess, manage and mitigate them, consistent with meeting its objectives described in section 1.2;
- describe the responsibilities that insurance companies have, and the actions that they might take, in respect of risk.

### 4.2 Types of risk

This section describes the various risks borne by insurance companies. There is no unique way of classifying these, but the following headings or similar are commonly found helpful.

#### 4.2.1 Capital risk

This is the risk that the company has, or will prove to have, insufficient capital to meet its obligations to policyholders, meet the solvency requirements to which it is subject, or

fulfil its business objectives. It includes various types of insurance or technical risk, such as mortality risk, expense risk and underwriting risk.

- **Mortality/morbidity risk** – This is the risk that mortality/ morbidity risks will develop in a manner more adverse to the company than allowed for in its premium and/or reserving bases leading to unexpected increased costs in future for the company
- **Expense risk** – This is the risk that expenses will be higher than allowed for in the premium and/or reserving basis leading to unexpected increased costs in future for the company
- **Underwriting risk.** – This is the risk that the standard that the company applies in accepting risks is different to that allowed for in setting premium rates leading to higher claims than anticipated

#### 4.2.2 Reserve risk

This is the risk that the company's reserves are, or will prove to be, inadequate to meet its liabilities to policyholders or otherwise in respect of which they have been established.

#### 4.2.3 Asset risk

This encompasses several risks:

- **market risk** = the risk that the value of and/or the yield on the company's assets will change in such a way that they are no longer adequate to meet its liabilities, or such as to adversely affect its solvency position; closely related are **currency risk** (adverse movements in exchange rates) and **mismatching risk** (changes in asset value and/or yield having an adverse effect on the company's ability to meet its cash flow requirements);
- **credit risk** = the risk that a counter-party to which the company has an exposure through investments or debts will default on that investment; closely related is **reinsurance risk** where the company's exposure to a counter-party arises through reinsurance, for which credit is taken in the balance sheet.
- **liquidity risk** = the risk that the company's assets are not sufficiently liquid or readily realisable to meet its cash flow requirements.
- **currency risk** = the risk that changes in the value of assets because of movements in exchange rates are not matched by corresponding changes in the value of liabilities, thus having an adverse affect on the company's ability to meet its liabilities.
- **reinsurance risk** = the risk that where the company's exposure to a counter-party arises through reinsurance, for which credit is taken in the balance sheet either as an asset (general business) or as an offset to the liabilities (life business) but where the reinsurer fails to meet their share of the claims.

#### 4.2.4 Strategy/environment risk

This is the risk that the strategy adopted by the company, or the environment in which it operates, will have an adverse impact upon it in the short or long term. The nature of the company's customers, services or products, its distribution channels, its place in the market, and merger and acquisition activity are examples of factors likely to be relevant to this risk. So too are wider external factors, such as economic conditions, social and demographic developments, etc.

It also encompasses **legal risk** (adverse legal judgements), **tax risk** (adverse changes in taxation basis) and **regulatory risk** (adverse changes in regulatory requirements). The latter will be particularly relevant to the Jordan market new Decisions and Instructions are implemented.

#### 4.2.5 Control/operational risk

This is the risk that the company's management, structure, organisation, practices, internal systems and controls, culture or treatment of its policyholders are such that they will have an adverse impact upon it in the short or long term.

- Dominance risk - This is the risk that one individual, or a group of individuals, will exercise too much power within an organisation.

#### 4.2.6 Group/contagion risk

This is the risk that the company will be adversely affected by the activities of, or by events having a direct impact on, other companies in the group to which it belongs (where relevant).

### 4.3 Scales of risk

It is important to note that the above risks fall into, and operate and are influenced by factors at, several different **levels/scales**:

- risks specific to an **individual company**, e.g. its management; the extent of its investment in shares of a particular company;
- risks affecting the specific **sector**, or the whole, of the **industry** which a company operates in, e.g. new entrants to sector; selling to vulnerable group of consumers; increased longevity; changes in disclosure requirements for a particular product type; growth of e-commerce and virtual insurance;
- **wider** risks, e.g. domestic, regional or global economic downturn; financial, legal, social and demographic developments.

### 4.4 Concentrations of Risk

Whilst a particular risk may not pose a problem for a company, attention should be focused on the relationships between risks.

One example is the aggregate risk that results from writing a large amount of the same type of business. This can lead to systemic risk of under-pricing if the risks are not fully

understood. There may be changes in the underlying claims frequency and/or severity over time that can particular affect a company that is overly exposed in one area.

Other cases may arise where there are a series of minor or major risks that may not, in isolation adversely affect the solvency of an insurance company or companies. However should a combination of events occur simultaneously, the effect can potentially be serious. Particular attention should be paid to risks that are related or correlated in some way

#### 4.5 Regulatory response to risk: overview

The regulatory objectives described in section 1.2 and the nature of the risks borne by insurance companies described in section 4.2 together imply that the overall approach adopted by the Insurance Commission in responding to these risks should meet the following criteria:

- as in all others areas, it should have regard to the Insurance Commission’s objectives, including those relating to competition, innovation and proportionality; and, where these point in different directions in particular circumstances, balance these objectives;
- it should be **risk based**, focussing most attention on those companies likely to pose the greatest threat to the Insurance Commission meeting its objectives;
- it should not seek to achieve a zero failure regime; this is neither achievable in practice – failures can arise from unforeseen events or unexpected outturns – nor desirable, as it would lead to disproportionate costs being placed on consumers and an unacceptable loss of competition and innovation in the market; instead, the aim should merely be to identify, and take mitigating action in respect of, risk;
- related to the previous point, it should be based on a clear understanding and statement of both the **realistic aims** and **practical limits** of regulation; and make clear to third parties the remit and limitations of the Insurance Commission;
- it should seek to identify and analyse consumer, sector, industry and wider risks as well as those of individual companies;
- it should recognise and place **critical emphasis on the responsibilities of directors** of insurance companies for managing and mitigating the risks they bear; for being aware of the impact of their actions on consumers; and for ensuring that such responsibility is fully reflected in the governance, management and operational structures of the company;
- it should also recognise the responsibilities of consumers, but at the same time maintain pressure for high quality disclosure so that they are better informed;
- it should make appropriate use of the full range of regulatory tools available to the Insurance Commission;
- it should include the Insurance Commission having a **proactive** and challenging relationship with insurance companies, both at senior management and working level, with a closer level of involvement maintained with those companies for which the

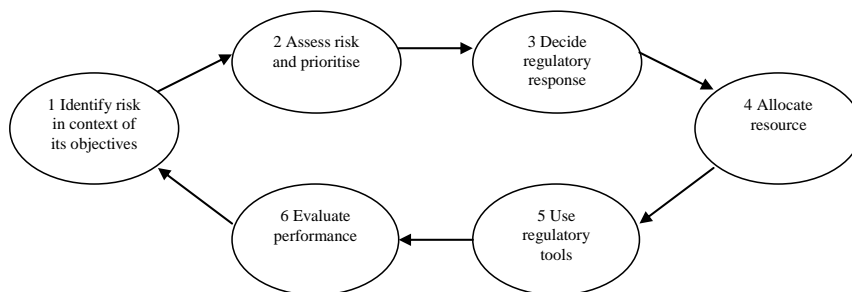
assessed level of risk is higher; basic oversight, to seek to ensure compliance with the Act and associated Decisions, Instructions and Guidelines, should however be maintained for all companies; where a company is responsive to requests from the Insurance Commission, it might receive a lighter regulatory touch; the relationship should be dynamic, in line with the assessed level of risk, and might include on site inspections, sample visits and sector based/themed visits;

- it should include an openness between the Insurance Commission and consumers, including liaison with relevant third parties, e.g. consumer groups, where appropriate;
- it should be sufficiently **flexible** to cope with a changing industry;
- it should seek to evaluate its own performance.

In summary, the overall objective should be to establish a flexible regulatory framework covering both prudential and conduct of business risks. This should be based on the proactive identification and prioritisation of risk, followed by the appropriate deployment of resource and use of regulatory tools. The framework should be appropriate for use throughout the economic cycle, i.e. in both difficult and buoyant times, but at the same time be sufficiently flexible to take account of changes in economic conditions and the wider environment.

#### 4.6 Risk based supervision

The figure below summarises how risk based supervision of insurance companies, as envisaged in section 4.3, might be operated by the Commission in practice:



##### 4.6.1 Assessment of risk and prioritisation

The assessment of risk should take into account **both**:

the **impact** that the risk would have on the ability of the Insurance Commission to meet its objectives were it actually to occur;

**and**

the **probability** of the risk occurring.

The assessment of impact is likely to be related to the scale of the company's activity. Possible indicators of this include its total assets or liabilities (for life business); its total

gross annual premium income (for general business); or its total number of policyholders (both). However, the Insurance Commission's own knowledge of the company should also be factored into this assessment.

The assessment of probability is harder. It should cover both conduct of business and prudential risks and take into account all the relevant types of risk described in section 4.2, including external and environmental risks. It will involve both quantitative (e.g. financial strength) and qualitative (e.g. management quality) aspects.

Potential sources of information to assist the Insurance Commission make these assessments include:

- data submitted by the company, and in particular its regular returns and financial statements;
- key financial and other indicators of risk (see section 5);
- sectoral analysis and peer review;
- advice from actuaries and other expert advisors;
- findings from on-site inspections (see section 10);
- Financial Condition Reports, where these are produced (for life insurance companies);
- any other information obtained through the exercise of intervention powers;
- discussions with the executive directors and actuary;
- discussions with the company's external auditors;
- discussions with other Jordan regulators, including the Central Bank of Jordan and the Jordan Securities Commission;
- discussions with foreign insurance regulators, where relevant;
- discussions with the company's non-executive directors and chair of its audit committee (if any);
- discussions with the Jordan Insurance Federation;
- discussions with professional bodies (including relevant actuarial bodies);
- discussions with consumer groups;
- the views of industry practitioners.

Prioritisation should then reflect the assessed level of risk.

Potential catastrophic risks should be considered, even where the probability of occurrence is extremely low.

Risks that are difficult to assess or model should not be ignored in favour of concentrating analysis exclusively on risks that can be better modelled. For example general insurance risks such as motor often have a lot of data, and the non-tariff part of the market may be highly competitive, so that there may be a temptation to spend a lot of time analysing the data available. Small number of risks of other classes may get disregarded, and hence insufficiently analysed.

It is recommended best practice that the Insurance Commission, where it considers this appropriate, **shares** its assessment of the level of risk with the company, to allow it to give its reaction and provide input, and to facilitate discussion of possible ways in which the risk might be reduced or mitigated.



It is also suggested that the Commission might usefully maintain a **watch list** of companies that display characteristics that historically have been a leading indicator for potential problems. Examples might include companies with unconventional business models or governance arrangements, or with individuals who are overly dominant or upon whom excessive reliance is placed.

#### 4.6.2 Resource allocation

It is recognised that resources within the Insurance Commission are limited, and that it is may not be possible for it to operate all the elements of a system of risk based supervision envisaged in this manual. However it is considered useful to outline the principles of such a system, so that appropriate resource allocation can be completed.

It is also recognised that extensive training for Insurance Commission staff is needed to help make its supervision more effective and efficient. In the longer term, it is recommended that the Insurance Commission should ensure that it has adequate staff recruited from existing or past insurance industry practitioners, either on a full time or, perhaps on a consultation basis.

#### 4.6.3 Regulatory tools

The Insurance Commission should always regulate insurance companies within the powers conferred on it by the Insurance Regulatory Act of 1999 and the applicable Decisions, Instructions and Guidelines. It should also act consistently, both as between companies and over time.

“Regulatory tools” should be interpreted widely. They include the use of appropriate **intervention powers** (see section 9) conferred on the Insurance Commission by Article (41) of the Insurance Regulatory Act, where necessary, to ensure, for example, that a plan to restore a sound financial position in the event of a risk leading to a breach of the 150% ratio of Capital Available to Capital Required.

But they also include:

- the use of data obtained under “normal” provisions of the Insurance Regulatory Act, such as that contained in the financial reports and quarterly regulatory forms;
- the taking of action of a routine nature and on an informal basis;
- the inclusion of appropriate provisions when drafting the Act and its associated Decisions and Instructions in the first place;
- the ability of the Insurance Commission to make amendments to these Decisions and Instructions from time to time, as provided for in the Act.

The latter power is useful as it provides flexibility in the regulatory framework to take account of changes in economic conditions and the wider environment.

There are four basic types of regulatory action, and the regulatory tools should be chosen appropriately for each of these:

Type of regulatory action	Example regulatory tools
Diagnostic = designed to identify, assess and measure risk	Use of financial and other indicators; on site inspection
Monitoring = track development of identified risk	Desk based review of annual returns
Preventative = limit or reduce identified risk	Provision of comparative information; encourage company informally to reduce level of its equity investment, for example
Remedial = respond to risk that has actually occurred	Delivery of restitution allowed for in Article 41(B) or Article 47 of the Insurance Regulatory Act, such as removing the directors responsible, fining directors and/or requiring a restoration plan following a breach of the minimum capital requirement

Intervention powers can be used under more than one of these headings: e.g. to seek to prevent a risk occurring, and to respond if that risk in fact crystallises.

Formal disciplinary action will often not be needed to satisfactorily address issues arising. However, this should be taken when necessary.

One particularly useful and flexible regulatory tool is the use of **skilled persons' reports**. These can, for example, help identify areas of weakness in a company's operation; check that remedial work has been carried out; assess the position in a company that has recently undergone a major change (e.g. change of control); and as a basis for taking enforcement action if the company is found lacking. Such reports might be requested from auditors, actuaries, IT consultants, etc.

Dialogue with **foreign regulators** can be helpful in some circumstances, and is sometimes necessary.

Taking action on an **industry wide level** can also sometimes be helpful. For example, an advertising campaign alerting consumers to particular issues might be more effective and efficient than focussing regulatory attention on individual companies.

#### 4.6.4 Evaluation

In theory, evaluation might be based on high-level proxy indicators focussed on the Insurance Commission's strategic objectives compared with outcomes; activity based measures; and performance results and process measures – especially the speed and efficiency of regulatory processes.

For individual firms, it should be based on the effectiveness of processes carried out in achieving the desired outcomes.

#### 4.7 **Senior management responsibility**

It is one of the cornerstones of insurance regulation generally that the directors of an insurance company have the responsibility for managing and mitigating the effects of

risks borne by it; for being aware of the impact of their actions on consumers; and for ensuring that such responsibility is fully reflected in the governance, management and operational structures of the company.

The Insurance Commission has a duty under the Insurance Regulatory Act, Article 6 to facilitate better management practices at insurers.

Following are examples of best practices relating to risk management:

- Insurance companies should have in place comprehensive risk management policies and systems capable of promptly identifying, measuring, assessing, reporting and controlling their risks. These policies and systems should be appropriate to the complexity, nature and size of the company's business. The risk management system should monitor and control all material risks.
- The insurance company should regularly review the market in which it operates, draw appropriate conclusions as to the risks posed and take appropriate actions to manage adverse impacts of the environment on the insurer's business.
- Larger insurance companies may need to establish a risk management function and risk management committee. In any event, the organisation and responsibilities of a risk management function must be documented, and the function adequately staffed.
- The Board of Directors is ultimately accountable and responsible for the performance and conduct of the insurer. The Board should set out the policies and strategies for the company, how they are to be attained and measures progress toward them. This includes due regard to the fair treatment of customers and information sharing with other stakeholders.
- The Board should be satisfied that the insurance company is organised in such a way that promotes the effective and prudential management of the insurer and the board's oversight of the management. Directors and senior managers should take appropriate practical responsibility for their companies' arrangements on matters likely to be of interest to the Insurance Commission and companies should vest responsibility for effective and responsible organisation in specific directors and senior managers.
- The insurer should have strategic underwriting and pricing policies that are approved and reviewed regularly by the Board
- The Board should not be unduly influenced by management or other authorities. It should have access to information about the insurer, and ask and receive additional information and analysis that it sees fit.

These are considered general prudential standards.

#### **4.8 Indicators of risk and relevant statutory requirements**

The purpose of this section is to provide, for each of the types of risk listed in section 4.2, financial and other indicators that the Insurance Commission might use to seek to identify and assess the level of that risk.

#### 4.8.1 Capital risk

##### 4.8.1.1 *Indicators*

- A negative or, low or falling level of solvency. This can be readily identified from the trend in the solvency margin ratio.
- No ready access to additional capital
- Overall losses before tax
- Reliance upon reinsurance financing. This can be disguised when reinsurance accounts are significantly delayed.
- High or increasing claims ratios
- High or increasing expense ratios
- Expense overrun on life business, that is the maintenance expenses of life business exceed the margins built into the mathematical reserves to cover these expenses
- Large volume of annuities
- Large volume of investment-linked contracts with investment guarantees
- Large volume of non-linked contracts with significant options or guarantees
- Large volumes of any general insurance class if loss making. Motor and Medical Expenses may need particular attention

##### 4.8.1.2 *Relevant Statutory Requirements*

None

#### 4.8.2 Reserve risk

##### 4.8.2.1 *Indicators*

- Weakness in reserving basis for life insurance, by factor
- Weakness by type of reserve for general business, by class
- Emerging under-provisions for general business, by class

##### 4.8.2.2 *Relevant statutory requirements*

The [Basis of Calculating the Technical Provisions Instructions of 2002] specifies rules for the calculation of the Unexpired Risks Provision and the Reported Claims Provision for General Insurance Business and for Life Assurance Business, the Mathematical Provision and Reported Claims Provision.

#### 4.8.3 Asset risk

##### 4.8.3.1 *Indicators*

- High level of inadmissible assets or other asset valuation differences

- Unusually large Capital Requirement for Interest Rate Risks or Cash flow mismatching reserve
- Significant currency mismatch
- Heavy reliance on reinsurance
- High level of gearing in investment-linked funds
- Inadequate liquidity (for example in a property fund) in investment-linked funds
- Low or reducing liquidity ratios
- Apparent unsuitability of assets held to match liabilities

**Comment [d12]:** Note: there does not appear to be a capital requirement for interest rate risks. Not sure about mismatching reserve.

#### 4.8.3.2 Relevant statutory requirements

.

#### 4.8.4 Strategy/environment risk

##### 4.8.4.1 Indicators

- Reliance on limited distribution; this should be clear from Form 29.
- Merger and acquisition activity
- Growth of business very high or very low
- Poor life business persistency
- Poor relative performance in league tables: e.g. investment performance of investment-linked funds

##### 4.8.4.2 Relevant statutory requirements

None

#### 4.8.5 Control/operational risk

##### 4.8.5.1 Indicators

- Poor completion of returns
- Adverse impression of management
- Identified systems weaknesses, data and security issues
- Inadequate risk management processes
- Inadequate anti-money laundering procedures
- Unit pricing issues on Investment-linked life business
- Over-reliance on one individual

**Comment [d13]:** The text above is based on the Decision on Asset Values of 2004. Because it is not in force, it calls into question the description of Asset risk indicators—they are probably valid, but the calculations may not be available to the Commission if not statutorily required.

- Inadequate segregation of duties
- Lack of clarity of roles and responsibilities of key staff
- Lack of / inactive non-executive directors

#### 4.8.5.2 *Relevant statutory requirements*

Note 33 to the annual accounts requires the company to describe its risk management policy.

#### 4.8.6 Group/contagion risk

##### 4.8.6.1 *Indicators*

- Shareholdings, debts or other financial transactions within group
- Financial weakness of other companies in group
- Lack of service level agreements relating to intra group services

##### 4.8.6.2 *Relevant provisions in the Law*

None.

## 4.9 **Asset Risk**

### • Introduction

Asset risk, which as explained in section 4.2.3 encompasses market risk, credit risk and liquidity risk, is a major potential threat to the financial strength of insurance companies.

This is reflected in the substantial number of provisions in the Insurance Regulatory Act and its Decisions and Instructions, which are relevant to, and designed to mitigate, these risks. In particular, the risk based solvency margin calculations incorporate factors which address asset risk, both market and credit risk. Among the most important of other provisions are:

- relating primarily to **market risk**:
  - the requirements in respect of life business to **ignore** potential future capital **gains on property and equities** and to apply a general prudential **margin** when calculating asset **yields** for the purpose of setting valuation interest rates;
- relating primarily to **credit risk**:
  - the **counter-party exposure limits**
  - the requirement in respect of life business to apply default **risk adjustments** when calculating asset **yields** for the purpose of setting valuation interest rates;
- relevant to **liquidity risk**:

**Comment [d14]:** Should this be deleted? Not clear that these are current requirements.

**Comment [d15]:** Is this requirement in force? Delete if not.

- the general requirement to hold assets of sufficient safety, yield and **marketability**
- the requirement in respect of life business to test the need to hold a cash flow **mismatching reserve**.

**Comment [d16]:** Is this requirement in force?  
Delete if not.

When considering asset risk, it is important to consider both **intrinsic** risk and risk that arises from external factors, and in particular the **use** to which a particular asset is being put:

- Certain asset classes clearly have higher intrinsic levels of market, credit and liquidity risk than others. For example, a government stock may have intrinsically low credit risk because of the security of the issuer, and short-term deposits are intrinsically both liquid and should be of low market risk.
- But account should also be taken of any liabilities such assets are being used to match. The same government stock might represent a significant market risk if it were short dated and being used to match long-term liabilities, and long term interest rates were expected to fall (producing an increase in the valuation interest rate and then a larger increase in the value of the liabilities than the rise in the value of the stock). Similarly, a longer term investment might represent a significant market risk if it was being used to match liabilities with a shorter average duration, and long term interest rates were expected to rise, leading to a greater fall in asset values than the corresponding fall in the value of the liabilities.

Related to this, it is also important to consider both **specific** and **general** market risk. The former relates to specific asset classes; the latter relates to more general risks, such as interest rate and exchange rate risk. Market movements are also not always independent and, as illustrated above, can impact on the liabilities of an insurance company as well as its assets.

- Characteristics of different asset types
- *Jordan equities*
- Likely, in theory, to produce a positive real (i.e. above price inflation) return over the long term;
- may generally out-perform fixed interest stocks over the long term;
- volatile market value;
- income stream potentially variable when earnings are volatile, but in practice often smoothed by the actions of the issuing companies in maintaining a steadier dividend distribution;
- there may be a relatively low initial income stream.
- *Jordan fixed interest government stocks*
- provide a guaranteed nominal (i.e. in fixed money terms) return;
- generally a relatively high income stream;

- in theory, marketable with low dealing costs; however there is a limited secondary market in Jordanian Government bonds, with most purchasers holding the stock from issue date through to maturity;
- there may be a choice of terms and coupons;
- can be useful for matching nominal liabilities.
- *Jordan property*
- likely positive real return over the long term;
- lumpy in that it is often only economic to purchase reasonably large units;
- there may be a limited supply of prime commercial properties;
- high dealing and running costs;
- may be useful for diversification away from Jordan equities;
- different sectors (industrial, offices, retail, farming, residential etc) have different characteristics;
- valuation expensive and subjective;
- rental income should, in theory, increase over time but the risk of a break in rental income exists;
- there can be volatile market values as results of fluctuating supply and demand.
- *Foreign equities*
- may be useful for diversification away from Jordan equities;
- massive total market;
- variable marketability, according to country of origin and by individual stock;
- currency risk (but the link of the Jordanian Dinar to the US Dollar mitigates this risk to some extent);
- some very low income yields;
- potentially *lower* dealing costs than for Jordan equities;
- possible adverse tax implications;
- opportunity for exposure to other economies, and sectors that may not be available within the ASE.
- *Jordan corporate fixed interest stocks*
- Limited availability;
- generally higher yield than equivalent government stocks;
- there may be security issues;



- there is a very limited secondary market so that investors buy to hold.
- *Foreign fixed interest stocks*
- potentially higher yield than Jordan government stocks;
- there may be security issues;
- generally less marketable than the corresponding foreign government stocks;
- currency risk (but the link of the Jordanian Dinar to the US Dollar mitigates this risk to some extent).
- *Mortgage and policy loans*
- may be fixed or variable interest;
- generally unmarketable;
- high expenses;
- normally secure; often higher yielding than government stocks;
- policy loans not suitable for an investment-linked funds.
- *Cash deposits*
- very liquid;
- often nil or low expected return,

- Liabilities of general insurance companies

- *Nature*

Claims outgo has a high level of uncertainty with occasional very large claims. Some claims may be for fixed monetary amounts but the bulk of them will not be, instead being affected by a variety of types of inflation. Some insurance companies may have some liabilities denominated in currencies other than Jordan Dinars. Future expenses may be even less certain than claims, but will be mainly Jordan Dinar denominated.

For short term liabilities fixed monetary assets are appropriate. Assets that may maintain their value in real terms may be more appropriate for long tail liabilities (unless these are fixed in monetary terms). Assets denominated in appropriate currencies should be held for any foreign liabilities.

- *Term*

Most of the liabilities are short term, although for some long tail classes there may be a proportion of liabilities stretching into the medium term and possibly even longer.

The bulk of the assets should therefore be invested short. If the assets have a much longer average term than the liabilities, the company is exposed to a rise in long-term interest rates producing a fall in the value of its assets greater than that of its liabilities (which would change little or perhaps not at all if not dependent on investments, as is

likely to be so in Jordan due to discounting of provisions not being permitted). A slightly longer average term might be considered acceptable on the grounds that the company will write some new business, but such reliance upon future premiums is potentially dangerous.

Because of the (relative) non-responsiveness of their liabilities to changing investment conditions, market risk can be significant for general insurance companies. It is also often not easy to match assets to their liabilities closely, with long tail liabilities in particular being problematic.

- *Liquidity*

A healthy level of liquidity should be maintained to meet any unanticipated claim payments. Marketability is similarly required.

- *Inflation as it affects General Insurance Liabilities*

General insurance claims are subject to various types of inflation, for example:

- Medical Costs – for medical expenses, motor injury claims etc
- Motor parts and labour – parts, to the extent that these are imported may reflect foreign inflation levels, and/or exchange rate movements. Local labour costs will vary independently.
- Legal costs, and the level of court/medical committee awards

All of the above forms of inflation may change in a different way to any government measured inflationary indices.

There are no asset classes available which match perfectly any of the above.

- *Investment freedom*

A general insurance company with assets well in excess of its liabilities and minimum Capital Requirements has scope to invest more freely, i.e. the constraints imposed by the nature and term of its liabilities is lessened.

- *Tax*

In general, tax has relatively little impact on a general insurance company's choice of assets.

One exception might be a reluctance to hold foreign assets where income payments are made net of a deduction for withholding tax, particularly if there is no double taxation agreement between Jordan and the foreign jurisdiction that is deducting the tax, so that it is not possible to reclaim the tax withheld.

- *Non-invested assets*

Significant non-invested assets (reinsurance recoveries, debtors etc) may mean that a lower proportion of the invested assets need to be invested short than would otherwise

have been the case. However, the risk of default on such items may cause the insurance company to look for a greater level of security from its invested assets.

- Liabilities of life insurance companies

- *Nature*

For companies writing with-profit or universal life business, there is an element of fixed payments (non-profit and the guaranteed parts of with-profit/universal life policies) and an element of non-fixed payments (the bonus or dividend element). For non-profit companies, the latter element is absent.

The fixed payments require investments with a known monetary return, i.e. fixed interest stocks, whereas investments backing the non-fixed items might be expected to be more equity or property based, with the aim of giving a positive real return. Fixed interest stocks may be less suitable for the bonus or dividend element, as policyholders may reasonably expect policy values to keep pace with inflation. Policyholders may also expect some risks to be taken to increase returns. Some equities, for example, might be appropriate.

For investment-linked contracts, the benefits – which comprise the bulk of the liabilities – are directly linked to the performance of the matching assets. There is, therefore, a greater level of investment freedom. However, assets invested in should be consistent with the stated investment objective of the fund.

For all types of contract, the company will need to reserve for future expenses. These will likely be closely linked to salary inflation. A mixture of fixed interest stocks and a small amount of equities, or index-linked securities, if available, might be considered suitable to hold in respect of these liabilities.

- *Term*

The term of the liabilities will depend on the type of business and the maturity of the company.

Individual, permanent business liabilities are likely to have terms stretching to say 25 years, with an average of say 15 years.

Group Life, Group Credit Life and individual term assurances are matched by assets of shorter duration.

An individual term assurance contract of term 20 or 25 years, which only pays a benefit on death (or other risk benefit) is matched by assets of relatively short duration (of up to 5 years).

- *Liquidity*

Some liquidity, i.e. holding either cash or readily realisable investments, is needed to meet day-to-day surrenders or other immediate benefit payments, but overall liquidity

may be less of an issue for life insurance companies than it is for general insurance companies.

This again depends on the business mix written by the company. Short term risk business (including group and credit life), and term assurances have many of the characteristics of general business, and similar liquidity requirements.

Premium income can be used to a limited extent to meet outgo, although reliance on uncertain premium income is potentially dangerous.

- *Investment freedom*

A life insurance company with assets well in excess of its liabilities and minimum Capital Requirements has scope to invest more freely, i.e. the constraints imposed by the nature and term of the liabilities is lessened.

- *Tax*

In some countries the tax position of life insurance companies may be very complex and would typically exert some influence over investment policy. In Jordan this is not the case, and tax considerations should have little or no influence on investment strategy.

- Implications for the Commission and insurance companies

The central task facing the Commission with regard to asset risk is to satisfy itself that the relevant provisions in the Act and its Decisions and Instructions have been complied with.

For some of these, most notably the asset valuation rules, the Insurance Commission will need to place reliance on the company's auditors, although it should use the information provided in the returns to seek to identify any apparent clear breaches of these rules. At some point, however, it will need to form a view as to the suitability of the assets held by the company, both of themselves and in relation to its liabilities.

This is not an easy task, and one that requires considerable judgement. It is hoped, however, that the material in the preceding subsections will offer some assistance. Generally, only a modest level of equity investment would be expected to be held by a general insurance company (the average for such companies in the UK in 2001 was 15% of total assets), with a significantly higher level for life insurance companies (42% of total assets in the UK in 2001, although a lower figure would be expected in Jordan due to its much lower proportion of with-profit or universal life business). Other large items in UK general insurance companies' 2001 balance sheets were reinsurance recoveries (29% of total assets), bonds (25%) and investments in group undertakings (7%).

The Insurance Commission should also stay alert to actions that insurance companies themselves might take in response to asset risk. These might include, for example:

- cutting bonus or dividend rates, or using more terminal and less reversionary bonus;
- reducing or eliminating options and guarantees, especially investment performance guarantees;
- increasing surrender penalties;
- writing more investment-linked and less conventional life business;

- withdrawing from some or all parts of market, or reducing new business;
- reducing the level of equity investment;
- increasing charges under investment-linked contracts;
- increasing premium rates;
- injecting additional capital;
- switching from government to corporate fixed interest stocks to increase yields in an effort to reduce its liabilities;
- switching from corporate to government fixed interest stocks to reduce credit risk;
- making first or increased use of asset-liability modelling, stress or scenario testing or dynamic financial analysis;
- introducing stricter internal investment guidelines.

Whilst some of these may be welcome (e.g. increase in capital), others might give rise to concerns on whether policyholders reasonable expectations, are being complied with or to regulatory issues. For example, a move to corporate fixed interest stocks might (but might not) compromise security; an increase in charges might lead to inequity. The Insurance Commission needs to strike a balance in considering such issues. But in the end, staying solvent is the greatest priority.

The Insurance Commission should also be mindful of the potential impact of its actions on the market as a whole. For example, imposing unduly onerous reserving requirements on insurance companies holding equities when equity values are falling, might potentially exacerbate the situation by forcing companies to sell equities.

- Mismatching reserves
- *Statutory requirement*
- Derivatives

Derivatives are financial instruments including futures, warrants, options, contracts for differences and interest and currency swaps. They are instruments that involve high levels of market (and potentially also credit) risk, which insurance companies should not use for speculative purposes.

The **asset valuation rules** assign a zero value to all derivatives outside investment-linked funds.

The valuation criteria in investment-linked funds are less clear. If these are met such that the derivative is an acceptable investment, then the derivative will generally be valued at market value.

It is a feature of derivatives that they can also become liabilities. Any such derivative must be valued under generally accepted accounting rules, with a suitable provision for the liability being established.

**Comment [d17]:** This doesn't appear to be a current requirement.

**Comment [d18]:** Not sure if this section should remain—discussion of derivatives useful, but don't believe they're dealt with in current rules.

#### **4.10 Reinsurance issues**

##### **4.10.1 Statutory provisions**

Reinsurance risk, arising from both the suitability of an insurance company's reinsurance program and the credit risk associated with its exposure to individual reinsurers, is a material part of the overall risk borne by an insurance company that uses significant amounts of reinsurance.

This is reflected in the [Reinsurance Instructions of 2002]. Article (3) of these Instructions requires that:

- The Board of Directors adopt a Reinsurance Policy including specified elements in Article (3) section A.
- Article (3), section B, specifies that the Board shall review the Reinsurance Policy at least annually.
- Article (3), section C, states that the company must provide a copy of the Reinsurance Policy to the Director General annually, and when any changes are made.

##### **4.10.2 Assessment of reinsurance programs by the Insurance Commission**

There are several basic elements to this:

- Is the reinsurance consistent with the company's stated Reinsurance Policy?
- Is the reinsurer (and where appropriate, the reinsurance intermediary) licensed to accept risks in Jordan?
- Is the reinsurance suitable for the type of business for which it is being purchased, and for its intended purpose?
- Are the terms of the reinsurance acceptable, and is it being used in the right quantity?
- Is there a significant credit risk, and how can this be mitigated?
- Are catastrophe risks, in particular earthquake risks, covered to an extent considered acceptable by the Director General?
- Does the company retain sufficient risk so that it is acting as an insurance company, or is it effectively acting as a reinsurance intermediary? For small specialist classes of business it is quite possible for it not to be cost effective for a company to try to develop in-house expertise. For larger classes there is less justification for a local company to over-use reinsurance.

#### 4.10.3 *Reasons for using reinsurance*

- **Diversification:** Rather than writing a few large risks, the insurance company can write lots of smaller risks.
- **Larger risks:** The insurance company can increase the scope of business it writes, particularly by opening up acceptance of larger risks.
- **Reducing claims fluctuations:** By doing this, less capital is needed. Conversely, for a given level of capital, more business can be written.
- **Protect solvency position:** Reinsurance can help shelter the insurance company's excess of assets over liabilities from large claims. One specific example of this is protecting against *catastrophe*.
- **Smooth profits:** Reduced claims volatility also allows more stable year to year results to be declared, which is attractive to shareholders and financial markets.
- **Contribution to Expenses:** Reinsurance commissions, Profit sharing arrangements or just the difference between reinsurance premium rates and gross premium rates contributes towards a company's expenses and profits.
- **Premium rates:** Reinsurers are frequently working in many markets around the world, and have access to market statistics and other data that can be used to derive premium rates. It is common practice for products to be priced by taking the reinsurance rates and adding a loading for expenses and profit, for any product line for which is difficult to obtain adequate statistics to price internally or where there is greater pricing expertise within the reinsurer than the company can reasonably access.
- **Technical assistance:** Reinsurers are well placed and willing to provide useful technical services and advice. This would typically include underwriting and claims support.
- **Training courses:** Reinsurers typically run training courses for underwriters and claims managers.
- **New classes:** Insurance companies can gain experience in a new class of business without being exposed to too much risk (at the price of being unlikely to make much profit).

- **Enhance minimum solvency ratio:** Credit is taken in the calculation of the Solvency Ratio for reinsurance (subject to limits for life business).
- **Immediate acceptance:** If an insurance company has appropriate reinsurance arrangements in place, it can go on risk immediately it has underwritten the policy irrespective of its size. This prevents the risk of the buyer going elsewhere during any period of decision-making and delay that would otherwise result, and helps keep costs down.
- **Tax management:** Use of reinsurance can sometimes have tax advantages for the insurance company.
- **Other:** Reinsurance might be cheap if there is excess supply in the market. Financial support might be given to the insurance company through financing commission agreements. The insurance company may also be able to earn additional interest by holding on to the gross premium before passing anything on to the reinsurer.

#### 4.10.4 *Types of general business reinsurance*

Terminology within the reinsurance markets is often difficult to follow, and often different markets seem to use different terms to mean the same thing

There are two broad categories:

- **proportional** – the insurance company cedes a proportion of the risk, recovering that proportion of the claims from the reinsurer;
- **non-proportional** – the insurance company pays the reinsurer an agreed premium and the reinsurer starts to pay out for claims which exceed a specified limit, where that limit is usually defined across a block of business.

Within the proportional category, there are three types: quota share, surplus and excess of loss (individual risk)

- Under a **quota share** arrangement, the insurance company cedes a fixed proportion of each and every risk covered. The reinsurance premium is generally a fixed proportion of the gross premium.
- Under a **surplus** arrangement, the insurance company chooses what proportion of each risk to retain (generally smaller for bigger risks) and the rest is ceded to the reinsurer. The simplest form, and most common internationally, is where the ceding office retains a fixed sum assured on each policy. The reinsurance premium is again a fixed proportion of the gross premium.
- Under the **excess of loss (individual risk)**, the insurance company buys cover from the reinsurer to protect against large claims arising from individual risks. One difference between this and surplus reinsurance is that the reinsurance premium is **not** always a fixed proportion of the office premium.

Sometimes excess of loss (individual risk) is classified as non-proportional, as the premium is non-proportional, but the risk transferred is proportional. From the regulatory or solvency perspective, it makes sense to class these three together as proportional as we



would expect all but the largest companies to have some combination of the above to protect its portfolio unless the sums assured under the original policies were limited.

Within the non-proportional category, there are three types: excess of loss (defined event)/catastrophe, other aggregate excess of loss and stop loss.

- Under **excess of loss (defined event)/catastrophe**, the insurer buys cover to protect against many claims arising from a particular event, or any event over a defined period of time. Catastrophe covers have some unique features. Generally they cover claims under specified business classes arising from a single incident of no more than 72 hours duration (or sometimes a lesser period). Exclusions are common, for instance terrorism, nuclear, chemical and biological, war risks. If a region is particularly prone to earthquake risks then the amount of protection from this cause may be less than from other causes and/or an additional premium may be charged to provide cover from that cause. A particularly unusual feature of catastrophe cover is that some or all the cover will lapse once there has been a claim under the reinsurance. Catastrophe protections include reinstatement provisions that set out the terms under which the catastrophe cover may be reinstated. The number of reinstatements is usually limited to one or two, and reinstatements may be free, require a proportional premium payment, or even require a full years premium. Catastrophe cover policies are often expressed in US\$.
- Under **aggregate excess of loss**, it buys cover to protect against many claims arising from a particular cause over an accounting period. For example cover may be sought to pay all claims arising from asbestos, or from AIDS. This form of reinsurance doesn't tend to be very popular outside fairly specialised markets as it can be difficult to evaluate the value of the protection gained. It may be sought where the main reinsurer is imposing policy exclusions that the Insurer does not wish to or cannot pass on to the policyholder. A separate aggregate excess of loss arrangement with a second reinsurer could then cover the first reinsurer's exclusions.
- Under a **stop loss** arrangement, it buys cover to protect the retained portfolio against the total claims, typically as a percentage of net retained premium over an accounting period from defined classes of business. For example a Stop Loss arrangement could protect against claims exceeding 120% of net retained premiums

Proportional reinsurance can be written on a facultative or treaty basis:

- **Facultative** reinsurance is individually negotiated for a particular risk. It tends to be used for very large or unusual risks that fall outside the scope of a treaty. The period of the reinsurance corresponds to the period of the underlying insurance contract.
- A **treaty** allows an insurance company to place reinsurance on certain pre-defined risks, described in the treaty, automatically. This provides certainty and is administratively quicker and cheaper, but can be inflexible.

In theory non-proportional reinsurance could be on a facultative or treaty basis as well. In practice there is no real difference between the two as non-proportional business is invariably set up to protect a specified portfolio, for a set period (usually of one year).

A reinsurance arrangement can be written as risks attaching or on a risks occurring basis:

- **Risks attaching** means all the direct insurance contracts written under the reinsurance arrangement are covered until their natural expiry.
- **Risks occurring** means that only claims that occur during the period of the reinsurance arrangement are covered.

Typically quota share and surplus arrangements are written on a risks attaching basis, whilst excess of loss (individual risks) and non-proportional covers are generally written on a risks occurring basis.

The risks attaching basis provides better protection for the direct office, as there can be a danger that it will not prove possible to renew reinsurance cover, or that terms will be significantly worse on unexpired risks at the end of the year.

#### 4.10.5 *Types of life business reinsurance*

There are two main forms of proportional life reinsurance:

- **risk premium**, under which only the risk is reassured. The reinsurance premium rates reflect the pure cost of the risk plus a loading for expenses and profit, and would, for instance, increase with age for mortality risks. The reinsurance premium is determined by multiplying the sum reassured by the reinsurance premium rates. Typically permanent insurance policies are reinsured on a risk premium basis, such as endowments, whole of life, universal life and investment linked business.
- **original terms**, under which part of the whole sum assured is reinsured on a shared basis, the reinsurance premium paid being determined as the premium paid to the insurance company multiplied by the proportion of the sum assured that is reinsured. In general the reinsurer will pay additional **over-riding commission** in excess of the commissions payable to agents/brokers as contribution to the direct offices expenses. Term assurances are frequently reinsured on an original terms basis.

However it is not always the case that there is a distinction between the two types. The reinsurance of Group Life risks in particular, can be regarded as either risk premium or original terms reinsurance

**Original terms** reinsurance involves a sharing of the original contract. All premiums paid to the insurance company, and all claims arising, are split in the proportions of business retained and reinsured.

There are two ways in which the amount reinsured can be specified: individual surplus and quota share. Under **quota share**, a specified percentage of **each** life policy is reinsured. Under individual **surplus**, the reinsured amount is the excess of the original sum assured over the insurance company's retention limit on any individual life. An insurance company often uses a mixture of the two, retaining for itself a percentage of each policy up to a maximum retention.

On term or group life business the insurance company either provides the reinsurer with details of the premium rates on which the business is written, or with the level of reinsurance commissions it needs. If the premium rates are fixed then the reinsurer then determines the rates of reinsurance commission it is prepared to pay to the insurance

company for the business. If instead the commission levels are known the reinsurer calculates the appropriate direct office premium rates. In both cases the reinsurer is taking into account both its likely future experience and its knowledge of the quality of the insurance company's underwriting.

It is possible for the reinsurer to **deposit back** its share of the total reserve under a reinsured contract with the insurance company. The regulator of the insurance company might welcome such an arrangement if the reinsurer represented a significant credit risk. However the reinsured reserves under most life contracts are fairly low, so the impacts of depositing reserves back can be limited, and a more common way to achieve the same result may be to delay settlement of reinsurance accounts. It is preferable for any delays in settlement of accounts to be explicitly agreed in the reinsurance contract wording, or there may be relationship issues with the reinsurer.

The **Non-proportional** method of reinsurance most commonly used is **catastrophe excess of loss** reinsurance. These work in much the same way as in the general business case.

#### 4.10.6 *How much reinsurance?*

In theory, an insurance company should wish to use only as much reinsurance as it really needs. This is because reinsurers wish to make money, i.e. reinsurance should normally involve passing profit from the insurance company to the reinsurer.

Insurance companies should therefore rationally wish to minimise the extent to which they reinsure, consistent with maintaining adequate solvency, etc., assuming their business is profitable. If it is not profitable, they should stop writing it: reinsurance is not the answer to this problem.

The same arguments would encourage a company to use surplus or excess of loss reinsurance rather than quota share.

However there are often good reasons why more risk is reinsured than the theoretical ideal would suggest:

- If the reinsurer has provided support then additional reinsurance premium can be used to provide compensation for that support.
- Reinsurers may have minimum reinsurance premiums needed to support their expenses.
- If the supply of reinsurance is limited, then the reinsurer may be in a relatively strong position to negotiate terms
- If the insurance company has limited experience of a particular class of business, it can make sense to reinsure the bulk of the risk until it has gained the experience to retain greater quantities. This can lead to the insurance company almost acting as a broker for the reinsurance company, which is not in the longer term, advantageous for the development of the local insurance industry.

A particular issue that local companies (that is, companies that are not part of multinational groups) can face is that reinsurance providers are themselves generally part

of large multinational groups. This means that the local insurance company may have limited influence on the reinsurers that can dominate smaller markets.

#### 4.10.7 *Supply and Demand in Reinsurance – the Reinsurance Cycle*

Both direct insurance and reinsurance are subject to market cycles which have significant impacts on the supply and demand for insurance and reinsurance capacity in world markets.

This cycle can be summed up as:

- Demand for risk protection via insurance or reinsurance grows (or supply / capacity in the market reduces)
- Increased premium rates encourage more participants in the market, leading to greater capacity
- More participants lead to greater competition, leading to premium rate reductions
- Some or all market participants start to lose money, some withdraw from the market (or reduce their capacity).
- The cycle repeats.

Whilst often the direct insurance and reinsurance cycles are aligned, they can also be seriously out of sync. In 2004, in many world markets reinsurance capacity is limited and prices are high, but there are many local insurance companies.

This can mean that the reinsurance arrangements established are favourable to the reinsurance companies.

#### 4.10.8 *Suitability of reinsurance: examples*

- One way for an insurance company to **Reduce its minimum solvency ratio** is by using Quota share reinsurance to well rated reinsurers.
- Earthquake risks can be protected against by using **catastrophe excess of loss reinsurance**
- The investment part of with-profits or universal life business would generally be fully retained. Any attaching risk benefits would normally be reinsured on a **risk premium basis**
- Investment-Linked liabilities are generally not reinsured, attaching risk benefits will normally be reinsured on a **risk premium basis**
- Large industrial fire risks are often reinsured on **surplus or individual excess of loss bases**

#### 4.10.9 *Suggested questions for the Commission*

We understand that the Commission is considering acquiring the Remos software package developed by the Danish regulator to help it to appraise the suitability of each individual insurance company's reinsurance protections, and the exposure of each reinsurer to the Jordanian market as whole.

This appears to be a good mechanism for identifying certain problem areas, but the Commission should seek to understand company reinsurance programs, and not to become overly dependent on the output from a system however well that operates.

The following are suggested questions for the Commission to consider when appraising reinsurance programs:

- a) What is/are the reason(s) for the reinsurance?
  - to write greater volumes of business?
  - to protect against large / catastrophe exposures?
  - financial engineering (i.e. making the company's balance sheet look better)?
- b) Is the reinsurance too expensive?
  - Consider the reinsurer's result (i.e. gross – net figures) and the commission terms. This is especially important for reinsurance that is being used to write greater volumes of business (i.e. quota share and some surplus treaties).
  - It is useful to look at reinsurance results for different classes of business across the market as a whole. Reinsurance results are more volatile than direct office results, so looking at individual company's reinsurance results over a single year can be misleading.
  - The reserving basis used by the reinsurers may be more or less prudent than that used by the insurance company. If a class of business looks particularly profitable or unprofitable for the reinsurer, it may be worth investigating the reserving basis used by the direct company.
  - It may be useful to talk to other regulators to see how the cost of reinsurance in Jordan compares.
- c) Is the level of retention set at an appropriate level?
  - Many companies have one fixed retention that will tend to be their starting point for all classes. This will then be adjusted up or down for each class as they get more or less confident with it.
  - There are various statistical models that can be used to assess the appropriateness of the each company company's retention level, and it is reasonable to expect the actuary to comment on this.
  - The retention level should, theoretically, depend on the premium volumes written, and on the cover for the solvency margin. In practice for administrative reasons companies tend not to change their retentions that frequently, so the premium volume is used more as a guide. We suggest that the Commission compare the companys' retentions by premium volume, and question any that seem significantly out of line.
- d) Is the catastrophe retention small enough? And the level of cover high enough?
  - If in doubt, look in detail at what scenario testing the company has done, and what assumptions it is making.

- The market for catastrophe cover has been difficult since 2001, and it is possible that it will prove to be difficult to purchase adequate cover at realistic prices. The Commission may have to adopt a pragmatic approach to market conditions.
- e) What is the quality / spread of the reinsurers?
- The (Reinsurance Instructions of 2002) restrict the amount that can be placed with reinsurers based on their Group.
  - Where reinsurers with a poor credit rating are used, what is the justification for using them?
  - Is the company dependent on just one reinsurer? What would be the impact if that reinsurer defaults, or withdraws from the market?
- f) Has the level of debtors days increased? If so, are there disputes with reinsurers?
- g) Has the level of reinsurance recoveries (reinsurers' share of claims provisions as a percentage of gross claims reserves) increased / decreased? If so, is it understood why?
- h) Are there any known reinsurance disputes?
- i) Are there any significant commutations / commutation negotiations?
- j) Does the reinsurance contract look watertight? Are there any ambiguous clauses? What is the level of **legal risk** associated with the contract?

Where the Commission is unsure of the answers to these questions, it should consider asking the insurance company for further information. Where the level of credit risk associated with individual reinsurers appears too high, the Commission should consider requiring some form of security, e.g. a letter of credit or collateralisation / deposit back / financing commission arrangement.

#### 4.10.10 Financing arrangements

Financing arrangements **can** be a valid method of:

- strengthening an insurance company's reported solvency position where there is a genuine and material transfer of risk to an unconnected counter-party; and/or
- accessing overly prudent "economic reserves" (capital) within the technical reserves of life insurance companies.

**However** concerns arise when these obscure the underlying financial condition of an insurance company, or are designed to mislead customers or the insurance regulator.

Responsibility for deciding on the appropriateness of financing arrangements rests with the directors of an insurance company. In doing so, however, it is important that they should be satisfied of the purpose and effect of the arrangements, and the credit that will be taken for them for regulatory solvency purposes.

Risk premium reinsurance on life business sometimes has associated with it a **financing commission** arrangement to reduce the insurance company's new business strain. Reinsurance commission, related to the volume of business reinsured, is paid to the

insurance company at a very high percentage of the first premium. This is then repaid over a number of years by additions to the reinsurance premiums that would otherwise have been payable, the reinsurer taking into account the expected lapse experience on the reinsured business in determining these repayments.

In effect, this arrangement simply represents a loan from the reinsurer to the insurance company but presenting the loan in this way has one very important advantage over a straightforward loan. This is that the insurance company would be obliged to add the amount of a conventional loan to its liabilities, but this does not apply to the reinsurance commission. Therefore the company is able, in respect of the reinsured business, to initially increase its assets without a corresponding increase in its liabilities. This reduces the amount of its new business strain.

Deposits back **can** have a **financing** effect. In effect, a deposit back is simply a loan from the reinsurer to the insurance company but legally the reinsurer may write off this loan immediately it is made, even though in fact it fully expects the loan to be repaid. This means that the insurance company does not have to treat it as a liability and set up a reserve for it. The effect, in respect of the reinsured business, is again to initially increase the insurance company's assets without a corresponding increase in its liabilities, thereby improving its reported solvency position. It should be noted, however, that this only works if the reinsurer is prepared to legally write off the loan. Where a deposit back is used, interest on the deposit is added, and any repayments arising through claims deducted, each year until the deposit is exhausted and/or the business to which it relates runs off.

#### 4.11 Outsourcing and management agreements

The directors of insurance companies bear responsibility for all aspects of their operations, and must take reasonable care to establish and maintain such systems and controls as are appropriate to its business.

One area of operation that is a common cause for regulatory concern generally is that of delegation to an external party, or "**outsourcing**". It should be clear that an insurance company cannot contract out its regulatory obligations, and the company has to take steps to obtain sufficient information from the third party to enable it to assess the impact of the outsourcing on its systems and controls.

Outsourcing arrangements should be the subject of formal written **management agreements**, also known as service level agreements (SLAs). In assessing such a management agreement, the Insurance Commission should ensure that the accounts of the companies in question are not distorted by the agreement, or by any arrangements between them that could affect the apportionment of expenses and income. This is necessary to allow the Commission to gain a proper appreciation of the insurance company's returns, which is compromised if the full implications of the agreement are not understood. It also reflects the accuracy of the data in the returns in part depending on the quality of the contractor's record keeping, on which no report is received.

It is recommended best practice that the Commission adopts the following procedure in its consideration of management agreements:

- Its review should take into account the specific circumstances of the case, and in particular the nature and extent of the functions or tasks being contracted out. For example, the controls required for an agreement to provide complete underwriting and management services would be more extensive than those for one to provide only minor investment advice or an accounting service.
- The objective of the Commission should be to ensure that the management agreement contains adequate provisions to safeguard the interests of the insurance company and its policyholders.
- A management agreement is a medium by which control over the insurance company's operations could be assumed by outside contractors and fraudulently or negligently exercised. Such transfer of authority is inconsistent with sound and prudent management and also undermines effective supervision. It is therefore important that care should be taken to examine the management agreement closely to guard against this.
- The management agreement should provide for adequate monitoring by the insurance company of functions or tasks contracted out, e.g. with regard to income, expenses, fees, records, regulatory compliance, budgetary constraints, etc, to guard against fraud by the contractor.
- The Commission should, as an initial check, attempt to establish whether:
  - the relevant experience of the contractor is satisfactory, e.g. by reference to its track record within the industry or the experience of its management team;
  - anything adverse, or likely to arouse concern, about the contractor's ability or integrity, including its directors and managers, is known;
  - links (personal or shareholding) exist between the insurance company and the contractor, which could potentially lead to conflicts of interest;
  - the services to be provided by the contractor could effectively be undertaken by the insurance company itself at a lower or comparative cost. This is of particular concern in the case of a life insurance company contracting out services to a group undertaking. Care should be taken to ensure this is done on a reasonable cost basis, so that it is not to the detriment of with-profit or other policyholders;
  - the management agreement appears to be unduly advantageous in attributing benefits or excessive authority (e.g. control over business policy or over the services to be provided) to the contractor;
  - the management agreement is signed by a suitably senior representative of the insurance company, e.g. the Finance Director or other director with some knowledge or experience of the business being contracted out;

and, where concerns over any of these points arise, take these up with the insurance company at the earliest opportunity.



- The Commission should then subject the management agreement to a more detailed examination, to ensure that it provides for the following:
  - 3 years' duration as a minimum;
  - the insurance company is able to stop the contractor carrying out its functions or tasks at will;
  - at least 6 months' notification of termination by either party;
  - automatic termination in the event of fraud, insolvency, inefficiency, misconduct, dishonesty or violation of the agreement;
  - arrangements for the run off of the business (where relevant) written prior to termination;
  - annually agreed business plan, indicating the type and level of business to be written (including reinsurance programs), which should not be significantly varied without the written agreement of the insurance company. The insurance company should, however, reserve the right to review and alter its underwriting policies at any time;
  - an annually agreed budget, clearly setting out the costs to the insurance company and the basis for remuneration, which should not be exceeded by more than, say, 10% without the prior written consent of the insurance company;
  - all funds of the insurance company held by the contractor to be kept in a separate account in the name of the insurance company, and cash held by the contractor to be limited to that necessary for handling the immediate business; the insurance company's funds should not accumulate in the charge of the contractor;
  - the contractor to provide the insurance company with regular management information, including:
    - monthly statements of written premiums, premium income, claims experience and the cash situation;
    - a report, at least quarterly, on progress in relation to the agreed business plan, and explanations of any significant variations or events;
    - a full report annually, or as justified in other circumstances;
    - such other information as the insurance company considers necessary to safeguard its interests;
  - all books, papers, computer files and other records relating to the business of the insurance company remain in law the property of the insurance company and must be returned on termination of the agreement without further charge;
  - the contractor, in carrying out its duties, to observe all requirements imposed on the insurance company by the Law and its associated Instructions and Decisions, and to undertake to make all books, papers, computer files and other records relating to the business of the insurance company available to the Commission on demand;

- the management agreement is not generalist or vague in its description of the role of the contractor, but specific about the assignments to be undertaken by it and the time scales for completion;
- The Commission should seek legal advice if it considers this necessary (this should generally not be the case).
- If and once satisfied, the Commission should merely indicate to the insurance company that it has no objections to its entering into the management agreement (i.e. avoid as far as possible giving a positive endorsement of it); retain a copy of the final version of the agreement.

#### 4.12 Group issues

##### 4.12.1 Group undertakings: ground for rejection of application for a licence

The Director General might consider rejecting an application for a licence where the Company is part of a wider group, that the organisation, management and structure of the group is such as to hinder the effective supervision of the Company by the Commission. The Instructions for Granting and Renewing the License to Transact Insurance Business (No. 1, 2003) do not specifically address group issues, but the Commission appears to have latitude to consider them, given that the application must include company business plans, sources of funds, and lists of proposed management and their qualifications to meet various conditions stipulated in the Act. With respect to establishing a branch of a foreign insurer, the Instructions specify that the license application must include a profile of the parent company and its organization.

##### 4.12.2 Group solvency

In circumstances in which one insurance company wholly owns another as a subsidiary, the available assets in the subsidiary may, in some jurisdictions, provide cover not only for its own solvency margin but also, to the extent that these are given value in the parent's balance sheet through its investment in the subsidiary, cover for the parent's minimum solvency ratio as well. A similar situation also arises (to a smaller extent) in the case of participations. As a result, it is possible for the reported solvency position of each of the two companies to be stronger than that which would be reported were they one company.

Given this effect, known as “**double gearing**”, it is important for an insurance regulator to monitor not only the reported solvency positions of each individual insurance company in an insurance group (= a group whose ultimate parent company is an insurance company or an insurance holding company) but also that of the insurance group as a whole.

In Jordan, the requirement to take the admissible value of an investment in a financial subsidiary or associate as zero should remove this problem in Jordan in relation to any subsidiaries of Jordanian parent companies.

However it is important for the Insurance Commission to be aware of this issue when looking at companies who have a head office outside Jordan, or a parent insurance company outside the country. In most jurisdictions it is possible for some value to be

placed on the subsidiary, varying from the excess capital available to the book value of the subsidiary. It may be possible for a group, of which the Jordanian company or branch is part, to make use of double gearing outside Jordan, so that the group would be less strong than if it was wholly Jordan regulated.

It may then be worth considering what would happen if there were problems with the solvency of the parent operation, and whether there would be any knock-on impacts on the Jordanian company.

#### 4.12.3 Links between banks and insurance companies

Circumstances in which an insurance company is linked by shareholding to a bank have the potential to raise regulatory concerns, and specifically prudential concerns about:

- the financial strength of the bank, and its ability to support the insurance company's minimum solvency ratio – either as an asset if the insurance company owns shares in the bank, or as provider of additional capital if the bank owns shares in the insurance company; and
- the implications of the insurance company's exposure, via the bank, to banking risks.

In respect of existing shareholdings, it is recommended best practice that the Commission stays in close contact with the regulator responsible for the bank, in order to receive early warning of any adverse developments affecting the bank and regular updates of its solvency position, profitability, capital and dividend requirements.

When approached with a proposal for an insurance company to acquire new shares in a bank, or vice versa, it is recommended best practice that the Commission assesses the proposal in close consultation with the regulator responsible for the bank, having regard to the following factors:

- the size of the resulting aggregate shareholding in percentage terms;
- the relative size of the insurance company's available assets and the bank's non-capital liabilities;
- in the case where the insurance company will own shares in the bank, the relative size of the insurance company's investment with its Capital Available, and therefore (a) its capacity to provide further capital to the bank in the future if required, and (b) the impact on the level of cover for its solvency margin resulting from the value of its investment being given no value in the solvency margin calculations;
- the nature of the business of both companies; their financial condition, recent profitability and quality of management; and any other relevant issues;
- whether the acquisition is seen as a portfolio investment, or whether benefits of synergy might arise;
- any potential support or liabilities from other material shareholders, or any letter of comfort provided by the insurance company in support of the bank's operations;

## **5 ASSESSMENT OF RESERVES**

### **5.1 Introduction**

The purpose of this section of the manual is to:

- provide the Commission with guidance on the calculation of reserves in general and theoretical terms, and how this dovetails with the specific valuation of liabilities rules described in section 2;
- outline techniques that are, or might be, used by the Commission to seek to assess the adequacy of reserves established by an insurance company.

The main emphasis is on reserves for general business, given the small volumes of life business in force. Brief comments are also included on mathematical reserves for life business in section 5.10 of this manual.

We suggest that the Commission refer the detailed scrutiny of the returns submitted by all life insurance companies to independent actuarial advisors, which process should include, among other things, an appraisal of the company's reserving methodology and assumptions. There may also be some value in independent actuarial advice being sought on general business.

The assessment of reserves is important, as it is central to ensuring compliance with the liability valuation rules, non-compliance with which undermines the protection for policyholders these are intended to provide. It is also difficult as, in many cases, the valuation rules are not prescriptive. A good deal of judgement is therefore involved.

### **5.2 Provisions for general business: an overview**

At any point in time, a general insurance company will have an outstanding liability in respect of claims events that have happened but not yet been fully settled. This liability can be split into several components:

- reported claims that have not yet been fully settled (although partial payments may have been made);
- claims from events that have happened but not yet been reported;
- claims thought to have been fully settled but which re-emerge with a further claim;
- expenses of handling and settling claims.

In addition, the company will have a further liability in respect of the unexpired portion of policies on its books at that point in time.

The insurance company will periodically try to assess these liabilities. This process involves two important elements:

- technical: using various techniques to estimate the amount of claims it will ultimately have to pay;

- judgmental: deciding the degree of conservatism wanted within the estimates and how much it should set aside now – as a “reserve” or “technical provision” – to meet these expected payments.

Sections 5.3 and 5.4 outline techniques used to determine the provisions for the liability in respect of claims events that have happened, but not yet been fully settled, namely the **outstanding claims provision**. Sections 5.5 to 5.7 outline techniques used to determine the provision for the liability in respect of the unexpired portion of policies in force, leading to the **unearned premium provision** and **unexpired risk provision**. Additional technical provisions are covered in sections 5.8 and 5.9.

### 5.3 Outstanding claims provision: individual case estimates

#### 5.3.1 Theory

One possible approach to estimating outstanding claims is for claims handling staff to examine each claim at the valuation date individually and make an estimate of the amount required to settle the claim.

Where this approach is taken, the company must be very careful in its treatment of:

- the assessors’ view of the expected delay until payment;
- allowance for claims inflation;
- allowance for claims handling expenses;

as the claims data itself is likely to be very heterogeneous.

The most likely approach to be adopted is to require claims assessors to provide their estimate of the expected amount of the claim **in today’s terms** and the expected **date** of payment. This facilitates more consistent treatment of inflation (and discounting if relevant) between different classes of business. Claims should be aggregated by type within classes to allow for particular trends for different types of claim. Direct claim expenses (e.g. legal fees) only would generally be included in the claim amount, with indirect expenses added as a loading to the total.

**Disadvantages** of individual case estimates include:

- time consuming and expensive;
- subjective;
- possibly biased;
- difficult to check;
- access to data may be limited;
- not comprehensive (IBNR needed separately).

**Advantages** include:

- uses all available data;
- allows for qualitative factors;
- valid when no suitable model exists.

Individual case estimates might be best in circumstances where there are few claims outstanding (not too expensive and may be very different from each other); for large claims (worth using all available data and significant to overall result) or where other methods are inappropriate.

### 5.3.2 Requirements of the Law

The valuation rules in Jordan

- require the use of individual case estimate;
- **prohibit** any form of discounting.

See section 2.3.4.

## 5.4 **Outstanding claims provisions: statistical methods**

### 5.4.1 Introduction

The basic idea behind all statistical methods is that there has been some regularity in the way that claims have been settled in the past, and that this can be relied upon to estimate what will happen in the future.

Different methods use different sets of assumptions, which may or may not hold in certain circumstances. Understanding the assumptions gives insight to the limitations of each method, and therefore which might be the best to use in a particular set of circumstances.

This section covers the following statistical methods:

- basic chain ladder method;
- inflation adjusted chain ladder method;
- separation method;
- average cost per claim method;
- Bornhuetter-Ferguson method.

### 5.4.2 Tabulating past claims

If past experience is a reliable guide to the future, we should start by tabulating past claims data.

#### **Example**

Assume that all claims are settled within 5 years of an accident and consider a valuation as at 31/12/03. Tabulate claims as follows:

	settlement delay in years ("development year")					
year of accident ("origin year")	1996	C(96,0)	C(96,1)	C(96,2)	C(96,3)	C(96,4)
	1997	C(97,0)	C(97,1)	C(97,2)	C(97,3)	C(97,4)
	1998	C(98,0)	C(98,1)	C(98,2)	C(98,3)	C(98,4)
	1999	C(99,0)	C(99,1)	C(99,2)	C(99,3)	C(99,4)
	2000	C(00,0)	C(00,1)	C(00,2)	C(00,3)	C(00,4)*
	2001	C(01,0)	C(01,1)	C(01,2)	C(01,3)*	C(01,4)*

	2002	C(02,0)	C(02,1)	C(02,2)*	C(02,3)*	C(02,4)*
	2003	C(03,0)	C(03,1)*	C(03,2)*	C(03,3)*	C(03,4)*

Then:

- C(99,3) represents claims paid in 1999 for accidents in 1996;
- C(99,0)+C(99,1)+C(99,2)+C(99,3)+C(99,4) represents total claims paid for accidents in 1999;
- C(00,0)+C(99,1)+C(98,2)+C(97,3)+C(96,4) represents total claims paid in 2000;
- C(01,3) represents claims that will be paid in 2004 for accidents in 2001;
- claim amounts marked \* are those which are unknown at the valuation date, and their total is the amount that will be paid after that date for accidents occurring prior to that date – i.e. **total outstanding claims** at the valuation date.

Note that claims that have been incurred but not reported (IBNR) at the valuation date **will** be included in one of the \* cells in the row corresponding to the year when the accident happened.

If there is some stability in the delays from accident date to settlement date, then we can use the known claim amounts in the table to estimate the unknown \* cells. Such stability may be referred to as a **stable claims development** or **stable claims run-off**. As the known claims data is at the top left hand triangle of a square of data completed by the \* cells, such tabulations of data are often referred to as **run-off triangles**.

#### 5.4.3 Basic chain ladder method

This is best illustrated by example.

##### Example 1

Consider the following claims data:

year of accident ("origin year")	settlement delay in years ("development year")			
	JDM	0	1	2
2001	25	12	5	
2002	51	21	C(02,2)	
2003	60	C(03,1)	C(03,2)	

If we believe the basic assumption that the claims run-off is stable, then we could estimate the unknown C(03,1) as:

- $60 \cdot 21 / 51$  – OK, but ignores 2001 accidents data; or
- $60 \cdot (21/51 + 12/25) / 2$  – perhaps better, gives equal weight to 2001 and 2002 accidents data; or
- $60 \cdot (21 + 12) / (51 + 25)$  – probably best, weights 2001 and 2002 accidents data by amount of claim payments in those years.

This is the basic principle behind the method. However, whilst this can be applied to individual claims amounts as above, it is more usual to apply the method to **cumulative**

claims data. This is to seek to avoid undue distortions from small individual claims. Re-tabulating the above claims on a cumulative basis gives:

year of accident ("origin year")	settlement delay in years ("development year")			
	JDm	0	1	2
2001		25	37	42
2002		51	72	C(02,2)
2003		60	C(03,1)	C(03,2)

C(03,1), C(02,2) and C(03,2) are then estimated, **using the maximum data available** identified above as the best of the three alternatives, as:

- $C(03,1) = 60 \cdot (72+37) / (51+25) = 86.05$ ;
- $C(02,2) = 72 \cdot 42 / 37 = 81.73$ ;
- $C(03,2) = C(01,1) \cdot 42 / 37 = 86.05 \cdot 42 / 37 = 97.68$ .

The estimated total claims outstanding is then:

- $(C(02,2)-72) + (C(03,2)-60) = (81.73-72) + (97.68-60) = \mathbf{JD47.41m}$ .

In larger run-off triangles, it is necessary to calculate explicitly the **development ratios** for each development year (bj), where in the above example:

- $b1 = (72+37)/(51+25) = 1.4342$ ; and
- $b2 = 42/37 = 1.1351$ .

### Example 2

Consider the following claims data:

year of accident ("origin year")	settlement delay in years ("development year")					
	JDm	0	1	2	3	4
1999		125	104	65	32	9
2000		120	98	57	27	
2001		148	124	75		
2002		143	110			
2003		138				

Step 1 – calculate cumulative claim amounts:

year of accident ("origin year")	settlement delay in years ("development year")					
	JDm	0	1	2	3	4
1999		125	229	294	326	335
2000		120	218	275	302	
2001		148	272	347		
2002		143	253			
2003		138				

Step 2 – calculate development ratios:

$$b1 = (229+218+272+253)/(125+120+148+143) = 1.8134;$$

$$b2 = (294+275+347)/(229+218+272) = 1.2740;$$



$$b3 = (326+302)/(294+275) = 1.1037;$$

$$b4 = 335/326 = 1.0276.$$

Step 3 – complete table:

year of accident ("origin year")	settlement delay in years ("development year")					
	JD'm	0	1	2	3	4
1999		125	229	294	326	335
2000		120	218	275	302	310.34
2001		148	272	347	382.98	393.55
2002		143	253	322.32	355.74	365.56
2003		138	250.25	318.82	351.88	361.59

where  $250.25 = 138 * b1$ ;  $322.32 = 253 * b2$ ;  $351.88 = 318.82 * b3$ ; etc

Step 4 – calculate estimated total claims outstanding:

$$\bullet (310.34-302)+(393.55-347)+(365.56-253)+(361.59-138) = \mathbf{JD391.04m}.$$

The key **assumptions** underlying the basic chain ladder method are:

- for each origin year, the amount of claims paid in each development year is a constant proportion of the total claims from the origin year;
- no explicit allowance for claims inflation but implicit allowance made, the weighted average of claims inflation within past data being projected into the future.

This implicit inflation assumption is fine if inflation in the past has been stable and if the same rate of inflation is expected in future. Otherwise, a more explicit allowance for inflation is required.

#### 5.4.4 Inflation adjusted chain ladder method

The key **assumption** underlying the inflation adjusted chain ladder method is:

- for each origin year, the amount of claims paid **in real terms** in each development year is a constant proportion of the total claims **in real terms** from the origin year.

The only difference from the basic chain ladder method is that it works in constant money terms and not in actual monetary values. However, there are a lot more calculations involved:

- first the original claims data needs to be converted to constant money terms – usually to the most recent origin year – based on best estimates of claims inflation in each prior year;
- the basic chain ladder method then needs to be applied to these adjusted data;
- finally, estimates of future claims inflation need to be used to adjust the amounts in each future origin/development cell to the appropriate year of payment.

Again, the method is best illustrated by example.

#### **Example**

Consider the same claims data as in Example 2 for the basic chain ladder method.

year of accident ("origin year")	settlement delay in years ("development year")					
	JD'm	0	1	2	3	4
1999		125	104	65	32	9
2000		120	98	57	27	
2001		148	124	75		
2002		143	110			
2003		138				

Assume that inflation in each of the years 1999/2000 to 2002/3 has been 6%, and that future inflation is expected to be 2% for 2003/04 and 4% pa thereafter.

**Step 1** – adjust past claims data to 2003 prices:

year of accident ("origin year")	settlement delay in years ("development year")					
	JD'm	0	1	2	3	4
1999		157.81	123.87	73.03	33.92	9
2000		142.92	110.11	60.42	27	
2001		166.29	131.44	75		
2002		151.58	110			
2003		138				

where  $157.81 = 125 * 1.06^4$  etc

**Step 2** - calculate cumulative adjusted claim amounts:

year of accident ("origin year")	settlement delay in years ("development year")					
	JD'm	0	1	2	3	4
1999		157.81	281.68	354.71	388.63	397.63
2000		142.92	253.03	313.45	340.45	
2001		166.29	297.73	372.73		
2002		151.58	261.58			
2003		138				

**Step 3** – calculate development ratios:

$$b1 = (281.68 + 253.03 + 297.73 + 261.58) / (157.81 + 142.92 + 166.29 + 151.58) = 1.7685;$$

$$b2 = (354.71 + 313.45 + 372.73) / (281.68 + 253.03 + 297.73) = 1.2504;$$

$$b3 = (388.63 + 340.45) / (354.71 + 313.45) = 1.0912;$$

$$b4 = 397.63 / 388.63 = 1.0232.$$

**Step 4** – complete table:

year of accident ("origin year")	settlement delay in years ("development year")					
	JD'm	0	1	2	3	4
1999		157.81	281.68	354.71	388.63	397.63
2000		142.92	253.03	313.45	340.45	348.34
2001		166.29	297.73	372.73	406.72	416.14
2002		151.58	261.58	327.08	356.90	365.17
2003		138	244.06	305.17	333.00	340.71

where  $244.06 = 138 * b1$  etc

Step 5 – calculate individual claim amounts at 2001 prices:

year of accident ("origin year")	settlement delay in years ("development year")					
	JD'm	0	1	2	3	4
1999		157.81	123.87	73.03	33.92	9
2000		142.92	110.11	60.42	27	7.88
2001		166.29	131.44	75	33.98	9.42
2002		151.58	110	65.50	29.82	8.27
2003		138	106.06	61.11	27.82	7.71

Step 6 – adjust for future inflation:

year of accident ("origin year")	settlement delay in years ("development year")					
	JD'm	0	1	2	3	4
1999		157.81	123.87	73.03	33.92	9
2000		142.92	110.11	60.42	27	8.04
2001		166.29	131.44	75	34.66	9.99
2002		151.58	110	66.81	31.64	9.12
2003		138	108.18	64.83	30.70	8.85

where  $8.85 = 7.71 * 1.02 * 1.04^3$  etc

Step 7 – calculate estimated total claims outstanding:

- $108.18 + 66.81 + 64.83 + 34.66 + 31.64 + 30.70 + 8.04 + 9.99 + 9.12 + 8.85 = \mathbf{JD372.81m}$ .

This somewhat lower result compared with that under the basic chain ladder method is as expected, the level of future inflation being lower than that experienced in the past.

#### 5.4.5 Separation method

The separation method is based on the same **assumption** as the inflation adjusted chain ladder method that:

- for each origin year, the amount of claims paid **in real terms** in each development year is a constant proportion of the total claims **in real terms** from the origin year

However, unlike the inflation adjusted chain ladder method, where past claims inflation data is obtained from an external source, with the separation method the past inflation assumptions are derived from the past claims data itself.

Specifically, the method expresses past claims data in the form:

- $C_{(y+m,n)} = C_{y+m} * \text{inflation factor } (m+n) * r(n)$

where  $C_{y+m}$  = total claims paid for origin year  $y+m$  expressed in year  $y$  prices and  $r(n)$  = the proportion of claims in real terms for each origin year paid in development year  $n$ .

A **further assumption** is then made that for each origin year, the number of claims reported in the first development year is proportional to the total claims amount in real terms for that origin year, i.e. that past claims data can be expressed in the form

- $C_{(y+m,n)} = N_{y+m} * \lambda (m+n) * r(n)$

where  $N_j$  = the number of claims for origin year  $j$  reported in development year 1 and  $\lambda(s)$  is the inflation factor ( $s$ ) above after absorption of the constant of proportionality. (This is a major assumption, and many practitioners believe that this method is over parameterised and is therefore rarely reliable in practice.)

Given tabulated claims data, a matrix of  $\lambda$ 's and  $r$ 's can be determined and solved, given that  $r(0)+r(1)+\dots+r(n) = 1$  assuming that all claims are settled within  $n+1$  years.

Again, the method is best illustrated by example.

### Example

Consider the same claims data as before, and suppose that in addition the number of claims in origin year  $j$  reported in development year 1 ( $N_j$ ) is as shown. Assume that future inflation is expected to be 2% for 2003/04 and 4% pa thereafter.

year of accident ("origin year")	settlement delay in years ("development year")						
	JDm	$N_j$	0	1	2	3	4
1999	100	100	125	104	65	32	9
2000	95	95	120	98	57	27	
2001	103	103	148	124	75		
2002	97	97	143	110			
2003	93	93	138				

**Step 1** – divide by  $N_j$  to derive matrix of  $\lambda$ 's and  $r$ 's:

year of accident ("origin year")	settlement delay in years ("development year")						
	JDm	$N_j$	0	1	2	3	4
1999	100	100	$\lambda_{0r0}$	$\lambda_{1r1}$	$\lambda_{2r2}$	$\lambda_{3r3}$	$\lambda_{4r4}$
2000	95	95	$\lambda_{1r0}$	$\lambda_{2r1}$	$\lambda_{3r2}$	$\lambda_{4r3}$	
2001	103	103	$\lambda_{2r0}$	$\lambda_{3r1}$	$\lambda_{4r2}$		
2002	97	97	$\lambda_{3r0}$	$\lambda_{4r1}$			
2003	93	93	$\lambda_{4r0}$				

models:

year of accident ("origin year")	settlement delay in years ("development year")						
	JDm	$N_j$	0	1	2	3	4
1999	100	100	1.250	1.040	0.650	0.320	0.090
2000	95	95	1.263	1.032	0.600	0.284	
2001	103	103	1.437	1.204	0.728		
2002	97	97	1.474	1.134			
2003	93	93	1.484				

**Step 2** – solve the triangle:

- as  $r_0+r_1+r_2+r_3+r_4 = 1$ ,  $\lambda_4 =$  sum of lowest diagonal = 3.720;
- hence  $r_4 = 0.090/3.720 = 0.0242$ ;

- next estimate  $\lambda_3$  **using the maximum data available** (as in basic chain ladder method);  $\lambda_3 = \text{sum of second lowest diagonal}/(1-r_4) = 3.598/0.9758 = 3.687$ ;
- hence  $r_3 = \text{sum of column 3}/(\lambda_3+\lambda_4) = 0.604/7.408 = 0.0816$ ;
- similarly  $\lambda_2 = \text{sum of third lowest diagonal}/(1-r_3-r_4) = 3.118/0.8942 = 3.487$ ;
- hence  $r_2 = \text{sum of column 2}/(\lambda_2+\lambda_3+\lambda_4) = 1.978/10.894 = 0.1816$ ;
- similarly  $\lambda_1 = \text{sum of fourth lowest diagonal}/(1-r_2-r_3-r_4) = 2.303/0.7127 = 3.232$ ;
- hence  $r_1 = \text{sum of column 1}/(\lambda_1+\lambda_2+\lambda_3+\lambda_4) = 4.409/14.127 = 0.3121$ ;
- similarly  $\lambda_0 = 1.250/(1-r_1-r_2-r_3-r_4) = 1.250/0.4005 = 3.121$ ;
- hence  $r_0 = \text{sum of column 0}/(\lambda_0+\lambda_1+\lambda_2+\lambda_3+\lambda_4) = 6.908/17.247 = 0.4005$ .

Step 3 – check the  $\lambda$ 's and  $r$ 's for reasonableness:

Proportion of claims in real terms for each origin year paid in each development year:  
 DY0 = **40.05%**; DY1 = **31.21%**; DY2 = **18.16%**; DY3 = **8.16%**; DY4 = **2.42%**: this looks OK.

Claims inflation from year to year:

1999/2000 =  $\lambda_1/\lambda_0 - 1 = \mathbf{3.56\%}$ ; 2000/01 =  $\lambda_2/\lambda_1 - 1 = \mathbf{7.91\%}$ ; 2001/02 =  $\lambda_3/\lambda_2 - 1 = \mathbf{5.74\%}$ ; 2002/03 =  $\lambda_4/\lambda_3 - 1 = \mathbf{0.90\%}$ : this also looks OK.

Step 4 – use the  $r$ 's,  $\lambda_4$  and the future inflation assumptions to complete table:

year of accident ("origin year")	settlement delay in years ("development year")						
	JD'm	Nj	0	1	2	3	4
1999	100	125	104	65	32	9	
2000	95	120	98	57	27	8.72	
2001	103	148	124	75	31.89	9.84	
2002	97	143	110	66.84	31.23	9.63	
2003	93	138	110.13	66.65	31.14	9.61	

where  $110.13 = 93 * r_1 * \lambda_4 * 1.02$ ;  $9.63 = 97 * r_4 * \lambda_4 * 1.02 * 1.04^2$  etc

Step 5 – calculate estimated total claims outstanding:

- $110.13 + 66.84 + 66.65 + 31.89 + 31.23 + 31.14 + 8.72 + 9.84 + 9.63 + 9.61 = \mathbf{JD375.68m}$

#### 5.4.6 Average cost per claim method

There are several variants of this method but the basic **assumption** underlying all of them is of stability of **average claim amounts**.

The method starts off like the inflation adjusted chain ladder method by adjusting past claims data into constant money terms. This triangle of data is then divided by a second triangle containing data on the **numbers** of "claims handled" in each origin/development year, to give a triangle of average claim amounts, from which an overall average claim for each development year is calculated. The basic chain ladder method is then applied to the triangle of claims numbers to give estimates of the numbers of claims that will be

paid in future development years. These numbers are then multiplied by the average claim amounts for each development year, and finally adjusted for assumed future inflation.

“Claims handled” are not uniquely defined: the most important thing is to use a definition that gives maximum stability over the period of run-off.

Again, the method is best illustrated by example.

### Example

Consider the same claims data as before:

year of accident (“origin year”)	settlement delay in years (“development year”)					
	JD'm	0	1	2	3	4
1999		125	104	65	32	9
2000		120	98	57	27	
2001		148	124	75		
2002		143	110			
2003		138				

and suppose that in addition the numbers of claims handled in each origin/development year are as follows:

year of accident (“origin year”)	settlement delay in years (“development year”)					
		0	1	2	3	4
1999		57	41	21	6	1
2000		59	41	18	5	
2001		62	45	23		
2002		54	40			
2003		56				

Assume that inflation in each of the years 1999/2000 to 2002/03 has been 6%, and that future inflation is expected to be 2% for 2003/04 and 4% pa thereafter.

Step 1 – adjust past claims data to 2003 prices:

year of accident (“origin year”)	settlement delay in years (“development year”)					
	JD'm	0	1	2	3	4
1999		157.81	123.87	73.03	33.92	9
2000		142.92	110.11	60.42	27	
2001		166.29	131.44	75		
2002		151.58	110			
2003		138				

where  $157.81 = 125 * 1.06^4$  etc. This step is identical to that for the inflation adjusted chain ladder method.

Step 2 – divide by claims numbers to give average claim amounts in 2003 prices, and calculate overall average claim amount for each development year:

year of	settlement delay in years (“development year”)					
	JD'm	0	1	2	3	4

accident ("origin year")	1999	2.769	3.021	3.478	5.653	9.000
	2000	2.422	2.686	3.357	5.400	
	2001	2.682	2.921	3.261		
	2002	2.807	2.750			
	2003	2.464				

giving overall average claim amounts of DY0 = **2.629**; DY1 = **2.844**; DY2 = **3.365**; DY3 = **5.527** and DY4 = **9.000**.

Step 3 – apply basic chain ladder method to claims numbers:

*Step 3a* – calculate cumulative claim numbers:

year of accident ("origin year")	settlement delay in years ("development year")					
	0	1	2	3	4	
1999	57	98	119	125	126	
2000	59	100	118	123		
2001	62	107	130			
2002	54	94				
2003	56					

*Step 3b* – calculate development ratios:

$$b1 = (98+100+107+94)/(57+59+62+54) = 1.720;$$

$$b2 = (119+118+130)/(98+100+107) = 1.203;$$

$$b3 = (125+123)/(119+118) = 1.046;$$

$$b4 = 126/125 = 1.008.$$

*Step 3c* – complete the table:

year of accident ("origin year")	settlement delay in years ("development year")					
	0	1	2	3	4	
1999	57	98	119	125	126	
2000	59	100	118	123	123.98	
2001	62	107	130	136.03	137.12	
2002	54	94	113.11	118.36	119.30	
2003	56	96.31	115.89	121.27	122.24	

where  $96.31 = 56 * b1$  etc

*Step 3d* – calculate individual numbers of claims:

year of accident ("origin year")	settlement delay in years ("development year")					
	0	1	2	3	4	
1999	57	41	21	6	1	
2000	59	41	18	5	0.98	
2001	62	45	23	6.03	1.09	
2002	54	40	19.11	5.25	0.95	
2003	56	40.31	19.58	5.38	0.97	

Step 4 – multiply by overall average claim amounts in each development year

settlement delay in years ("development year")						
--	--	--	--	--	--	--

year of accident ("origin year")	JD'm	0	1	2	3	4
1999		149.85	116.60	70.67	33.16	9
2000		155.11	116.60	60.57	27.64	8.86
2001		163.00	127.98	77.40	33.35	9.79
2002		141.97	113.76	64.30	29.02	8.52
2003		147.22	114.64	65.88	29.73	8.73

where  $114.64 = 40.31 \cdot (DY1=2.844)$  etc

Step 5 – calculate estimated total claims outstanding by adjusting for future inflation:

- $(114.64+64.30+33.35+8.86) \cdot 1.02 + (65.88+29.02+9.79) \cdot 1.02 \cdot 1.04 + (29.73+8.52) \cdot 1.02 \cdot 1.04^2 + 8.73 \cdot 1.02 \cdot 1.04^3 = \mathbf{JD388.84m}$ .

One possible modification to the method is to apply the basic chain ladder method to the average claim amounts triangle as well as to the triangle of claim numbers. The product of the future origin/development cells from the two resulting run-offs would then give estimates of expected claim amounts in 2003 money terms.

If we wanted to examine only outstanding reported claims (i.e. handle IBNR separately), explicit use could be made of the known number of outstanding reported claims and average costs per claim applied to these.

A different approach would be to work with incurred claims data, and form averages using numbers of claims reported rather than claims handled. We could then project for each origin year the ultimate average claim size and ultimate claim number, say using the basic chain ladder method. Subtracting the amount of paid claims to date from the projected ultimate claim amount (= ultimate average claim size \* ultimate claim number) gives an estimate of claims outstanding.

#### 5.4.7 Bornhuetter-Ferguson method

The **concept** underlying this method is as follows:

- estimate the ultimate claim amount from a particular origin year by using a method **independent** of chain ladder techniques (e.g. use of individual case estimates);
- work backwards from the estimated ultimate claim amount, using the development factors from a chain ladder technique, to calculate the amount of claim that **ought to** have been paid by now;
- subtract this amount from the estimated ultimate claim to give an estimate of the amount outstanding.

Again, the method is best illustrated by example.

#### **Example**

Suppose that a class of business is expected to be completely run-off by the end of development year 4 and that the basic chain ladder method applied to the past claims data has generated the development factors:

- $b1 = 1.764$ ;  $b2 = 1.391$ ;  $b3 = 1.183$ ;  $b4 = 1.054$ .



Suppose also that an independent estimate of the total claims to be paid from 2001 accidents is **JD3.456m** and that the amount paid as at the end of 2001 is **JD1.472m**.

Then, based on the development factors and the independent estimate of the total amount payable from 2001 accidents, the **expected** total amount paid from 2001 accidents at the end of 2001 is:

- $3.456 / (1.054 * 1.183 * 1.391 * 1.764) = \text{JD}1.130\text{m}$ .

The original estimate of the **total** amount payable is then revised according to how the actual amount paid at the end of 2001 compares with the above estimate. In this case,  $\text{JD}0.342\text{m}$  ( $= \text{JD}1.472\text{m} - \text{JD}1.130\text{m}$ ) more claims have been paid at the end of 2003 than expected. Hence our revised estimate of the total claims to be paid from 2003 accidents rises to **JD3.798m** ( $= \text{JD}3.456\text{m} + \text{JD}0.342\text{m}$ ).

A **feature** of the method is that the original estimate of that part of the total claims to be paid that relates to the future is **not** affected by experience during the last time period. In the above example, the estimated **outstanding** claims before actual claims paid in 2003 were known as  $\text{JD}3.456\text{m} - \text{JD}1.130\text{m} = \text{JD}2.326\text{m}$ , and the estimated **outstanding** claims after actual claims paid in 2003 were known as  $\text{JD}3.798\text{m} - \text{JD}1.472\text{m} = \text{JD}2.326\text{m}$ , i.e. unchanged.

This feature is sometimes used to criticise the method, as are its dependence on an external claims estimate and run-off pattern. However, the method can be useful in some circumstances, e.g. for quickly estimating year-end reserves based on a full reserving exercise conducted as at the end of the third quarter of the year, by deducting from reserves at that date expected payments in the next quarter for each year of origin (and checking that nothing has happened during that time to invalidate such an approach).

#### 5.4.8 Variants on the methods

Claims data can be grouped differently. One disadvantage of using a run-off triangle is that there is very little data in the tail (i.e. the latest development year). This means that if this data is for some reason distorted or unreliable, the overall result could be badly affected. An alternative approach is to use a **run-off parallelogram**, where use is made in the tail of earlier years' data also. However, whilst this approach has greater statistical reliability, against this must be weighed the potential irrelevance of the older data.

A more fundamental variation is choosing a **different cohort** for the run-off. So far, all the run-offs we have considered have been based on **accident year**. Given this, we know that once the table is completed, it contains all claims in respect of accidents occurring before 31/12/03, and that the total of the \* cells is the claims outstanding as at 31/12/03 in respect of such accidents. Such outstanding claims automatically **include** provision for IBNR claims and also reopened claims. Further, if the claims data includes direct claims handling expenses, then the run-off estimates will also automatically include these.

Suppose instead, however, that **reporting year** were used for the run-off. Then the completed table will contain only all claims in respect of accidents **reported** before 31/12/03, and the total of the \* cells is the claims outstanding as at 31/12/03 in respect of such accidents only. Such outstanding claims thus **exclude** IBNR reserves, which will thus need to be estimated separately. Claims handling expenses will be included if the

claims data itself includes these. Reopened claims may or may not be included, depending on how such claims are coded. If they are tied back to the original claim file and included in the cohort of the year of the original claim, they will be included. If instead they are grouped with claims reported in the year of reopening, then they will be excluded, and will need to be estimated separately.

Now suppose that **underwriting year** were used for the run-off. Then the completed table will contain all claims in respect of accidents that have occurred or will occur under policies **written** before 31/12/03, and the total of the \* cells is the claims outstanding as at 31/12/03 in respect of such accidents. Such outstanding claims thus **include IBNR** reserves and also reopened claims, but they **also include the reserve for the liability in respect of the unexpired portion of policies in force at 31/12/03**. Claims handling expenses will be included if the claims data itself includes these.

Run-offs can be produced using more frequent than annual time units if desired (e.g. from very short tail business). It is also possible to use **different time units** on each axis of the run-off.

Run-offs can be produced of **incurred claims** rather than paid claims if desired. This can be useful where outstanding claims have been estimated by a different method, e.g. individual case estimates. For each accident year (say), the incurred claims in each development year represent the estimate at the end of that year of the total claims to be paid for accidents in that origin year. If they increase as we move to the right in the table, this provides evidence of **past under-reserving**. Estimated incurred claims for the final development year derived using a chain ladder approach give estimates of the total claims that will be paid for accidents in each origin year assuming stability in the extent to which the company has been under (or over) reserving in the past.

#### 5.4.9 Future claims inflation and claims expenses

Claims inflation is typically a mixture of different types of inflation (of wages, spare parts, court awards, etc), which may differ one from another. The safest way to deal with this is to keep different types of claim separate and use potentially different inflation assumptions for each. Average inflation rates may need to be used where data is too sparse.

Whatever is included for claims expenses in the base data used in statistical methods will determine what is included in the future estimates. Individual case estimates would typically include an estimate of direct expenses with indirect expenses allowed for by means of a loading to the total (but see section 5.3.2).

#### 5.4.10 Incurred but not reported claims (IBNR)

These will need to be estimated separately if individual case estimates have been used, or a statistical method that uses reporting year cohorts.

The amount of work done to estimate IBNR claims depends on the tail of the business and the overall significance of the class in the overall portfolio. For small or short tail classes, a simple averaging method might suffice as IBNR will not be large and there will be less uncertainty. Such methods might include:

- % of earned premiums in last month, or longer period;
- % of outstanding reported claims;
- % of claims, both paid and outstanding, from events in last few months.

None of these is particularly robust, the latter two based on claims generally being the least bad.

For large and long tail classes, a more detailed method is required. Generally, this would look separately at the two main elements of the expected amount of IBNR claims:

- expected **number** of IBNR claims \* expected **average cost** per IBNR claim.

In determining the **average cost**, it is important to recognise that the average cost per claim for IBNR claims **might** be very different from non-IBNR claims, depending on the class of business and type of claim:

- the IBNR average might be lower if the late reporting is due to the policyholder not being fussed (e.g. minor contents damage under household policy);
- the IBNR average might be significantly higher if the late reporting is due to a condition taking a long time to emerge (e.g. asbestosis, industrial deafness under employers' liability policy);
- **but** for IBNR claims incurred very recently, there is no reason why they should be significantly different.

An insurance company will use its previous IBNR experience to estimate the average cost per IBNR claim, looking particularly at:

- average cost of IBNR claims in the previous year;
- this average as a proportion of the average cost per claim for non-IBNR claims in same period;
- the most recent average cost per claim of non-IBNR claims;

and making suitable adjustments for claims handling expenses and inflation, and taking care over excesses, partial settlements and claims settled at nil cost.

### **Example**

Use the following data to estimate the average cost per IBNR claim for an IBNR reserve calculation as at 31/12/03:

- average cost in 2003 of claims that were IBNR as at 1/1/03 = JD454;
- average cost of all claims settled in 2002 = JD505;
- average cost of all claims settled in 2003 = JD545;
- price inflation 2001/03 = 3.5%;
- price inflation 2003/04 = 4%;
- claims handling expenses as % of claim amount = 15%.

### Solution

Implied claims inflation =  $545/505 - 1 = 8\%$ . This is well above the rate of price inflation, so assume a continuation of this rate for the estimate. Assuming that the JD454 excludes claim handling costs – which would need to be checked – the estimate would likely be taken as  $JD454 * 1.08 * 1.15 = \mathbf{JD564}$ .

For estimating **numbers** of IBNR claims, the insurer would typically construct a **delay table**, which shows the proportion of claims (by number) reported within n months of origin. This would then be applied to a table of claims reported by the year-end from each origin month.

### **Example**

Consider a class for which all claims are reported within 6 months, and that the number reported by 31/12 from each of the 7 months June to December are as follows:

Number of claims reported by 31/12 from each origin month						
Jun	Jul	Aug	Sep	Oct	Nov	Dec
1,083	1,060	1,002	934	878	663	325

Suppose further that an analysis by accident date and reporting date for previous claims has resulted in the following delay table:

Proportion of claims (by number) reported within n months of origin						
0	1	2	3	4	5	6
30%	64%	82%	91%	96%	99%	100%

Then the number of IBNR claims as at 31/12 can be estimated as:

- $(325/0.3 - 325) + (663/0.64 - 663) + (878/0.82 - 878) + (934/0.91 - 934) + (1,002/0.96 - 1,002) + (1,060/0.99 - 1,060) = \mathbf{1,469}$ .

This estimate could then be multiplied by the estimated average cost per IBNR claim to derive the **IBNR provision**. Alternatively, a different average cost per IBNR claim could be used for each month's contribution to the above total number of IBNR claims.

Use of a delay table is likely to be invalidated in circumstances in which the occurrence of claims has been unstable in recent months, or where the speed with which claims have been reported in the past is expected to change in the future (e.g. following a change in internal practice by the company).

Results from a delay table would be modified in the light of experience between the end of the accounting year and the date at which the IBNR provision is calculated. For short tail classes, what has happened in this period may in fact have removed much of the uncertainty surrounding IBNR at the valuation date.

#### 5.4.11 Potential distortions

Various factors may invalidate the basic chain ladder and other statistical methods. These include:

- errors in the data;
- large claims in past data – if there is no equivalent large claim outstanding, the estimate of outstanding claims will be overstated;
- large claims in outstanding claims – if there was no equivalent large claim in the past claims data, the estimate of outstanding claims will be understated;
- inflation (past and future) – assumptions made by various methods regarding this may be false;
- not fully run-off – especially for long tail classes, the assumption of claims being fully developed by the end of development year  $n$  may prove false due to the emergence of latent claims;
- catastrophe – likely to distort run-off but not always obvious what effect it will have;
- claims processes – changes in the company's procedures for reporting and settling claims can have a major impact by undermining the stability of run-off assumption;
- different types of claim – these need to be kept separate, otherwise changes in mix will produce distortion;
- lack of data/random errors – especially in relation to new classes, and classes with small numbers of claims or highly variable claims.

The average cost per claim method is particularly sensitive to anything that distorts the relationship between total claim amounts and numbers of claims, e.g. events giving rise to a large number of small claims, partial settlements and zero claims.

Understanding these factors and the effects they can produce helps give insight to steps that might be taken and/or modifications that might be made to the methods to make them more robust. The following **cross-checks** can also be used:

- using same method but with modified data/assumptions – sensitivity testing;
- use a different model and comparing results;
- comparing with individual case estimates;
- comparing results with simple totals, averages and ratios, both for previous years and other companies (e.g. estimated outstanding claims/premiums earned in last  $n$  years).

#### 5.4.12 Suitability of the methods

Not surprisingly, the advantages and disadvantages of statistical methods are essentially the converse of those for individual case estimates.

**Advantages** of statistical methods include:

- quicker and cheaper to produce;
- more objective;
- easier to check;
- allowance for IBNR can be incorporated automatically;
- good where access to data is limited.

**Disadvantages** include:

- do not make use of all available data;
- do not allow for qualitative factors;
- no suitable model may exist.

Statistical methods are most suitable for estimating outstanding claims when there are lots of claims outstanding; when there is stability in the claims development process; as a check on individual case estimates; where IBNR is large in overall terms; or when individual claims data is not available.

The choice of which method is more or less suitable in different circumstances follows from their different underlying assumptions. Average cost per claim methods are particularly sensitive to certain distortions (see above) but can be used to factor in known data ignored by other methods, potentially improving the estimates made. The Bornhuetter-Ferguson method is useful for making speedy updates to provisions derived using other methods, and for making estimates for the most recent years of origin, for which chain ladder methods are particularly prone to error due to lack of data.

#### 5.4.13 Implications for the Commission

The Commission might, in theory, use one or more of the statistical methods discussed above to check for reasonableness in the outstanding claims provisions held by an insurance company derived using individual case estimates, and it is recommended best practice that it should do so in cases where it has reasons to doubt the adequacy of the provision.

The Commission might also use the information contained in the preceding sections to assist it in assessing any application from an insurance company to use statistical methods to calculate its outstanding claims provision (see section 5.3.2).

### 5.5 **Provisions for unexpired risks: overview**

There are two ways of looking at unexpired risk (= the risk that has not yet been borne by the company in respect of policies that are mid-term at the valuation date) for the purpose of establishing provisions.

The first is to ask the **retrospective** question: how much of the premium that has been paid should be reserved to cover the unexpired risk? This leads to the **unearned premium provision**.

The second is to ask the **prospective** question: how much is needed now to cover the expected claims and expenses from the unexpired risk? This leads to what might be called the “**total** provision for unexpired risk”.

It is the **excess**, if any, of the **total** provision for unexpired risk over the unearned premium provision that is generally referred to as the **unexpired risk provision**, and this is the meaning of this term in Jordan.

### 5.6 **Unearned premium provision**

#### 5.6.1 Theory

The premium paid under a general insurance policy covers:

- claims, which are incurred in line with the incidence of risk;
- initial expenses including commission (acquisition expenses), which are incurred at outset;
- other expenses, which will be primarily claims related, and hence incurred in line with the incidence of risk;
- profit, which should arguably also be earned in line with the incidence of risk.

Therefore, if the policy has  $m\%$  of the risk before the year-end and  $(100-m)\%$  after the year-end, it is logical that the unearned premium provision (UPP) for the policy should be taken as:

- $UPP = (100-m)\% * (\text{premium} - \text{acquisition costs})$

and the UPP which the company should set up as a liability in its balance sheet is the sum of these amounts over all its policies.

A valid alternative is for the UPP for the policy to be calculated gross, as:

- $UPP = (100-m)\% * \text{premium}$

and for a compensating asset to be shown in the balance sheet in respect of that policy of an amount:

- $DAC = (100-m)\% * \text{acquisition costs}$

called a **deferred acquisition costs asset**. The UPP and the DAC that the company should set up as a liability and as an asset respectively in its balance sheet are then the sums of these amounts over all its policies.

In practice, the **incidence of risk** throughout the year will not be known exactly. An approximation which may be reasonable in some circumstances – but not others (for example where the level of risk depends on seasonal factors) – is to assume that the incidence of risk is broadly **even** over the year. **Time** rather than risk can then be used as the basis for splitting the premium.

For an annual policy with  $n$  days elapsed at the valuation date, the UPP and DAC (assuming this is the approach taken, see above) then become:

- $UPP = \text{sum over all policies } x \text{ of } \{(365-n(x))/365 * \text{premium}(x)\};$
- $DAC = \text{sum over all policies } x \text{ of } \{(365-n(x))/365 * \text{acquisition costs}(x)\}.$

These formulae reflect the **365ths method** of reserving. For non-annual policies, 365 would be substituted by the term of the policy in days.

An approximation to this calculation is to assume that, for policies written in each month of the year, the premiums were paid on average half way through that month. On this basis, policies written in December have 23/24ths of their life remaining, those written in November have 21/24ths etc, and the UPP and DAC then become:

- $UPP = \text{sum over all months } m \text{ of } \{(2m-1)/24 * P(m)\};$

- $DAC = \text{sum over all months } m \text{ of } \{(2m-1)/24 * AC(m)\};$

where  $P(m)$  and  $AC(m)$  are the aggregate premiums and acquisition costs for policies written in month  $m$ . These formulae reflect the **24ths method** of reserving.

A cruder approximation still is to assume that premiums are paid on average half way through the year and hence have 50% of their term remaining at the valuation date. This leads to a UPP of 50% of the total premiums for the year and to a DAC of 50% of the total acquisition costs for the year. If the further assumption is made that acquisition costs represent 20% of the premium on average, then the equivalent UPR calculated on a net basis is 40% of the premiums for the year. This approach is called the **40% method**.

Where premiums are outstanding or paid in instalments, the most common accounting treatment is to work from the policy inception date and hold a UPP as if the premium had been received in full, and treat premiums owed as a debtor item on the assets side of the balance sheet.

Adjustments to the UPP might be made to allow for mid-term policy alterations and lapses, some of which might actually be known about by the time the UPP comes to be calculated (in a similar way to IBNR). Allowance for lapses would increase the UPP as insurance companies typically provide a few days' cover after the policy has lapsed in anticipation of a late renewal rather than a lapse. In practice, however, these adjustments are rarely very significant.

#### 5.6.2 Requirements of the Law

The valuation rules in Jordan require:

- the UPP to be calculated on a gross basis,
- no DAC shown as an asset in the balance sheet;
- a separate calculation to be made for each contract, using the 365ths method

See section 2.3.2.

This means that the theoretical elements of the UPP for deferred acquisition costs, and for any variation of the incidence of the risk over the period of insurance must be allowed for within the unexpired risk provision.

Note that the legal specified method of calculating the UPP is correct in accounting terms, because it is consistent with the accounting treatment of receivable notes and post dated cheques, which are treated as assets. If a policy lapses part way through the year the UPP should be at least equal to the receivable notes/post-dated cheque asset, so that no accounting loss would be incurred.

#### 5.6.3 Implications for the Commission

It is recommended best practice that the Commission checks that:

- the UPP looks reasonable. Whilst not too much weight should be placed on this, the 50% mentioned in conjunction with the 40% method above provides a rough indicator for the ratio UPP/written premiums in previous year for annual premium contracts. Any large deviations from these figures might be queried,



- Any significant change in the ratio of UPP/written premiums from one year to the next might be queried

## 5.7 Unexpired risk provision

### 5.7.1 Theory

The unexpired risk provision (URP) is the **excess**, if any, of the **total** reserve for unexpired risk over the UPP. It is effectively a provision to provide for an expected future loss on unexpired policies.

There are two commonly used methods for calculating the total provision for unexpired risk: the claims ratio method and the claims frequency method.

#### 5.7.1.1 Claims ratio method

This method first estimates the **claims ratio**, i.e. claims as a % of premiums, expected in the coming year on the unexpired policies. This will be based on:

- the claims ratios for the most recent periods of exposure;
- claims inflation;
- recent changes in premium rates;
- any uneven incidence of risk.

The total reserve for unexpired risk is then given by:

- $\text{claims ratio} * (1 + \text{CE}) * \text{UPP}$

where CE is a loading to allow for any claims expenses not already included in the claims ratio.

#### Example

A general insurance company accounts for all its business on a quarterly basis. The amount of premiums written in each quarter of 2003 are Q1 JD150m; Q2 JD170m; Q3 JD190m; Q4 JD180m.

In September 2003, the company carried out a review of its expected claims experience for 2003 business and concluded that for business written to-date, the loss ratio for 2003 would be 120%. As a result of this review, premium rates were increased by 50% from 1/10/03.

Initial expenses are 20% of premiums written. Assume that no loadings for future administrative expenses are required beyond those allowed for in the loss ratio. Calculate the URP as at 31/12/03.

#### Solution

To simplify this calculation, all business is assumed to be written in the middle of the quarter, and quarters are taken as containing the same number of days.

$\text{URP} = \max(0, \text{total provision for unexpired risk} - \text{UPP});$

$\text{UPP} = (150/8 + 170 * 3/8 + 190 * 5/8 + 180 * 7/8) = \text{JD}358.75\text{m};$

$\text{Total provision for unexpired risk} = (150/8 + 170 * 3/8 + 190 * 5/8) * 120\% +$

$180 * 7/8 * (120\%/1.50) = \text{JD}367.5\text{m};$

Hence URP = JD8.75m.

#### 5.7.1.2 *Claims frequency method*

This method works from first principles, in a similar way to assessing a premium, with the total unexpired risk provision given by:

- unexpired exposure \* expected claim frequency \* expected cost per claim

where the latter element includes an allowance for expenses.

#### 5.7.2 Requirements of the Law

The valuation rules in Jordan are not prescriptive as to how the total provision for unexpired risks, and hence the URP, must be calculated.

See section 2.3.3.

#### 5.7.3 Implications for the Commission

The existence of a URP in respect of a particular class of business suggests that future losses on that class are expected. It is recommended best practice that the Commission considers:

- querying any lack of a URP in respect of a class of business that it would expect to be loss making;
- crudely if the profit and loss account for a class of business shows an expected loss ratio before URP of 110%, then if premium rates haven't changed during the year, then the URP might be of the order of 10% of unearned premiums
- the general actuary's report containing the method and assumptions used to calculate any URP held.

### 5.8 **Catastrophic Risks Provision**

#### 5.8.1 Theory

The purpose of a catastrophic risk provision is to help protect the company's net retention in the event of a catastrophe.

There are several complex mathematical models used by reinsurance brokers and reinsurance companies around the world.

However these models tend to allow for large natural disasters only, and so exclude:

- Unpredictable man-made disasters (such as war risks)
- Smaller catastrophic events that may be more likely to lead to claims. For example:
  - Bus or train crashes, where there is personal accident cover
  - Motor accidents affecting multiple lives under group life cover
  - Serious fires affecting more than one property

#### 5.8.2 Requirements under the Law

The [Basis of Calculating the Technical Provisions of 2002] states that “the Catastrophic Risks Provision shall be calculated in accordance with the experience of the Company and the estimations made by it”.

### 5.8.3 Implications for the Commission

The commission should take a pragmatic view of the catastrophic risk provisions held by companies:

- If the company has had any catastrophic claims over the past 5 years, then it may be reasonable to take an average of the last 5 years claims, plus a prudent margin, as these claims would have impacted on the net retention of the company after today’s catastrophe reinsurance program.
- If there were a serious catastrophe, would the company remain solvent, assuming that it was then allowed to hold a zero Catastrophic Risk Provision at the end of the year following the catastrophe.

## 5.9 Other Technical Provisions

One example of an “Other Technical Provision” sometimes found is an equalisation provision. This is an additional reserve set up to help smooth profits between years.

There is no explicit statement within the [Basis of Calculating the Technical Provisions of 2002] regarding Other Technical Provisions, but there are lines in Forms 5 and 8 for changes in Other Technical Provisions.

## 5.10 Reserves for life business

It is recommended best practice that the Commission should refer the detailed scrutiny of the returns submitted by all life insurance companies to independent actuarial advisors.

The returns do not provide sufficient information to permit an independent valuation of the liabilities in respect of life business. The detailed scrutiny process is therefore focussed on checking the reported reserves for reasonableness and forming a judgement as to whether the reserving methods and assumptions used, which must be disclosed, are compliant with the liability valuation rules. Such judgement is required because these rules are generally not prescriptive (see section 2.4).

Any doubts over the adequacy of the reserving basis are then raised with the company by the Commission, on the basis of advice and recommended questions to the company provided to it by independent actuarial advisors in a “detailed scrutiny report”, which also includes comments on the company’s solvency position (both current and likely future), operational performance and other matters.

The following are among the most important items that should be considered in appraising a life insurance company’s reserving basis:

- the appropriateness of the valuation methodologies adopted for the various types of business written;
- whether the interest rates used in the valuation are supported by the risk adjusted yields on the assets matching them; the adequacy of the margins they contain; and the

**Comment [d19]:** Most of section 2.4 has been proposed for deletion. Replacement text consistent with this para?

adequacy of the risk adjustments that have been applied to asset yields to allow for income and capital default risk;

- the prudence of the mortality and disability assumptions used;
- the adequacy of the aggregate allowance made in the valuation for expenses, including the costs of closure to new business 12 months after the valuation date and of any expected expense overruns in respect of continued new business in the 12 months following the valuation date;
- the prudence of the per policy expense parameters and other assumptions used in the calculation of non-unit reserves held in respect of investment-linked contracts;
- whether the Capital Required for Interest Rate Risks has been calculated on an appropriate basis fully complying with the latest Decision or Instructions issued by the **Commission**;
- the adequacy of any reserve held or required for cash flow mismatching;
- the adequacy of any reserves held or required in respect of options and guarantees;
- the adequacy of any reserves held for tax;
- the adequacy of the allowance made in the valuation for **Policyholders Reasonable Expectations**;
- the relative strength of the valuation basis compared to the company's peers and any significant changes in the strength of the basis in real terms since the previous year-end.

**Comment [d20]:** Delete given that there are no "latest decisions or instructions" on this topic, or leave in, as the reference does no harm?

**Comment [d21]:** Think this term comes from the unadopted instructions on life technical provisions. If so, delete.

## 6 FINANCIAL RATIOS - AN OVERVIEW

The following section is not intended to replace in-depth financial analyses or on-site examinations. However, the collection of ratios is intended to assist the Insurance Commission in targeting resources to those insurers in greatest need of regulatory attention.

The limitations of the ratios need to be recognised, in particular:

- the ratios cannot identify a misstatement of financial condition
- or, in certain circumstances a statement prepared in an incorrect format
- there remains the possibility of data errors

Important decisions should not be based on the type of analysis described in this section alone. Valid interpretation of the results of these ratios will require considerable judgement on the part of the examiner. It should be borne in mind that there exists a host of valid reasons why a company might be outside the usual range – including changes in corporate structure or restatements of prior periods etc.

Nevertheless, these ratios can be reasonably effective in distinguishing between sound and troubled companies.

### 6.1 Overall Business Ratios

#### 6.1.1 Solvency

Minimum Solvency Margin is taken to mean 150% of the Capital Required.

##### 6.1.1.1 *Solvency Ratio*

The ratio of Capital Available / Capital Required

This ratio is shown in Annex (1) of the Solvency Margin returns. The trends in the solvency ratio over time should be monitored. However whilst the solvency margin returns are required on a quarterly basis, the annual returns should be completed in more detail and have an actuarial sign-off. The solvency ratios submitted quarterly will, unavoidably, be less accurate than those submitted at the end of the year.

So whilst it is important to examine the quarterly returns and to consider any deterioration in the solvency ratio, it is more important to look at the year end solvency ratios, and to track how it is changing from one year end to the next.

##### 6.1.1.2 *Cover for Minimum Solvency Margin*

The Capital Available / Minimum Solvency Margin

It might generally be expected that insurance companies will have a solvency ratio well in excess of the 150% level needed to demonstrate solvency, other wise there is a significant risk that some unforeseen event or random fluctuation in claims experience will result in the solvency ratio falling below the minimum.

For general insurance business it would be expected that the level of free assets would be significantly greater than the statutory requirement.

For Life business the level of free assets expected to be needed would depend on the business profile written. For short term risk business it should be similar to general insurance business, whilst a company writing just investment-linked business without guarantees may be able to justify relatively small amount of free capital.

#### *6.1.1.3 The Solidity Ratio*

(Capital Available – Minimum Solvency Margin) / Total Technical Provisions

The Solidity ratio is a measure of how sensitive the company's solvency position is to changes in the technical provisions.

#### *6.1.1.4 (Capital Available – Capital Required) / net earned premium*

This ratio can be useful for companies with short term business only, as it shows how changes in the company's claims ratios would affect the solvency position of the company.

### 6.1.2 Profitability Ratios

#### *6.1.2.1 Pre-tax profit after any loan payments on debt capital / Average Core Capital during the year*

In the long term, a company must produce a reasonable rate of return on the capital invested by shareholders. If this is not achieved then the shareholders may not wish to continue supporting the insurance market, leading to mergers and acquisitions, and perhaps companies closing to new business.

It should be borne in mind that inadequate reserving in earlier years will overstate the profitability, which will then be expected to fall in later years as claims emerge (and claims reserves are possibly increased further).

This ratio might be distorted if shareholders equity changes significantly during the year.

#### *6.1.2.2 Return on capital employed (ROCE)*

Pre-tax profit before any loan payments on debt capital / average (core capital + supplementary capital + any debt capital) during the year

This ratio measures the overall return made on the capital in the business. For a business to be successful over the long term the ROCE needs to be in excess of the cost of debt capital, and in excess of yields on risk-free capital (usually taken as government guaranteed bonds).

#### *6.1.2.3 Gearing ratio*

Long term debt (including Supplementary Capital) / Core Capital

Long term debt should include any bank overdrafts that have been in place for some time, and so are effectively permanent.

Gearing ratios are used by capital markets, which tend to use some sort of simplified rule to determine whether a company is able to raise more debt capital, or whether it needs to raise more equity capital when additional capital is required.

Any capital raised by any form of financing reinsurance would normally be excluded, for the practical reason that it can be very difficult to identify such capital, though it is strictly a form gearing.

In general it is easier for a company to raise debt capital than it is to raise equity capital, although it can be market dependent, and may not always be the case.

It is preferable that, as far as possible, for insurance companies to protect their solvency position with Core Capital.

## **6.2 General Insurance Ratios**

### **6.2.1 Underwriting**

#### *6.2.1.1 Net Written Premium / Capital Available*

The usual range for this ratio is up to 300%.

In effect, it measures the adequacy of the capital cushion, net of the effects of premiums ceded to reinsurers, available to back the level of business written.

#### *6.2.1.2 Annual change in Net Written Premiums*

This ratio should be examined for each class of insurance, and in total

Increases can be as a result of:

- Increase market penetration / new or improved distribution
- Reduced competition in the market
- Increase in size of market, a result of economic growth, and/or new compulsory insurances
- Takeover of other companies or transfer of block of business
- Increased Retention and/or reduced cost of reinsurance
- Voluntary increases in premium rates, with volumes not too adversely affected
- Increases in tariff rates on motor insurance

Decreases may result from

- A company pulling out of a type of insurance contract
- Increased competition in the market
- Reductions in the size of the market due to an economic recession
- Loss of one or two large clients
- Loss of distribution
- Reduced retention and/or increased cost of reinsurance

- Voluntary increases in premium rates, with volumes adversely affected
- Decrease in tariff rates on motor insurance

Whilst it is always the profitability of any class of business that should be of greatest concern, changes in net written premiums can indicate which classes merit the closest attention.

#### *6.2.1.3 Annual change in Gross Written Premiums*

The changes in the gross premium written should be analysed by class. The changes in gross written premium for each class should be compared with the changes in net written premium to highlight the effects of changes in the reinsurance arrangements.

Other than reinsurance, the factors that lead to changes in the Gross Written Premium are the same as those that lead to changes in the Net Written Premium

### 6.2.2 Reinsurance Ratios

#### *6.2.2.1 Net Written Premium / Gross Written Premium*

The proportion of written premium retained by the company has to be sufficient to pay for its expenses and the cost of the risk retained by the company.

The direct costs that the company incurs should be higher than those incurred by the reinsurer.

So for instance if the reinsurance was straightforward 50% quota share, the net premium written / gross premium written should be well over 50%.

### 6.2.3 Liquidity Ratios

#### *6.2.3.1 Liquid Assets / Technical Provisions*

#### *6.2.3.2 Liquid Assets / Total Liabilities*

#### *6.2.3.3 Liquid Assets (excluding any amounts due from reinsurers) / Short Term liabilities*

#### *6.2.3.4 Liquid Assets / Net Claims Paid*

The nature of short term insurance is that claims payments can be volatile and may vary considerably from month to month.

The more volatile the claims experience, the greater there is a need to maintain liquid financial assets, in particular bank deposits.

The level of liquidity required will depend to some extent on the company's retention. Most reinsurance arrangements also allow for large claims, over a certain specified size to be paid immediately to mitigate impacts on the direct companies liquidity position

Problems with liquidity may arise from:

- Debts from agents or brokers taking a long time to be paid (or defaulting)
- Premium debts from direct clients also being paid slowly
- Reinsurance recoveries being slow



- Investment in illiquid assets such as property, unquoted equity or bonds
- Defaults of banks, leaving deposits frozen

Insolvent companies have sometimes demonstrated a decreasing amount of liquid assets to liabilities in their final years. The trend in the liquidity ratios may be of more importance than the actual result in a particular year.

#### 6.2.4 Claims (or Loss) ratio

6.2.4.1 *Net Claims ratio = Net Cost of Claims Incurred / Net Earned Premium*

6.2.4.2 *Gross Claims ratio = Gross Cost of Claims Incurred / Gross Earned Premium*

The claims ratios should be examined for each class of business, and in total.

The net costs of claims incurred is shown in Form 4 for life insurance, and Form 7 for general insurance

It is also important to examine the trends in claims ratios over time, and make comparison across the industry.

Poor claims experience may result from:

- Competition leading to low premium rates
- Insufficient use of rating factors compared to competition
- Poor use of reinsurance (particularly if the gross claims ratio is satisfactory, but the net claims ratio is poor).
- Poor control of claims
- Unexpected claims inflation
- Changes in the law, leading to claims deterioration
- Change in the claims environment leading to change in the underlying risk rates
- Catastrophic events
- Review of reserving for historical claims leading to an increase in the provisions held

6.2.4.3 *Expense ratio = Net Commission and Expenses / Net Earned Premium*

Note net commissions are commissions paid less any reinsurance commissions received (and can therefore be negative).

The expense ratios should, in principle, be analysed by class of business, and across a company. However the value of the analysis by class will depend on how accurately the company has been able to allocate expenses to each class of insurance, and any anomalies may be as a result of problems with the allocation process rather than the with the underlying business.

Trends over time are very important, as for instance, any new class will tend to have a high expenses ratio.

Net General Insurance premiums can be regarded as consisting of four components:

- a) Risk Premium
- b) Commission
- c) An allowance for expenses
- d) An allowance for profit

The higher the expense ratio, the less there is available to contribute to the cost of the risk and to profit.

Different classes of insurance will tend to have different expense ratios, and the mix of business written may make quite a lot of difference to the expense ratios experienced.

The most significant comparison may be between different companies, and those companies with the highest expense ratios should be monitored closely.

#### *6.2.4.4 Net Underwriting ratio = 1 - Underwriting Profit (Loss) / Net Earned Premium Income*

The underwriting profit (loss) is shown on Form 5 for Life Insurance, and Form 8 for General Insurance, and the net earned premium income is shown on Form 3 for Life Insurance and Form 6 for General Insurance.

The underwriting ratio is expressed as “1-“, so that for example if there was an underwriting loss of 5% of the premium earned the underwriting ratio would be 105%. Conversely an underwriting profit of 5% of earned premium is an underwriting ratio of 95%.

The ratios should be examined for each class, the trends examined, and comparisons made across the industry.

It is most important that companies make reasonable underwriting profits, although there will inevitably be fluctuations over time.

It can also be useful to look at the Gross Underwriting ratio, and to compare with the net results. It is not possible to do this fully accurately as the expenses of the reinsurance company are unknown, but nonetheless it is important for the long term stability of the market that all parties involved (direct and reinsurance) receive a reasonable return.

#### *6.2.4.5 Overall Operating Ratio = 1 - Underwriting Profit (loss) after allocation of investment income and gains / Net Earned Premium*

As well as underwriting profits or losses, insurance companies also earn investment income and may make capital gains on the invested assets backing the technical provisions.

The overall Operating Ratio, therefore, is a measure of the true profitability of the class of business written.

When investment returns are low it may be possible to disregard this ratio, but when investment returns are higher, the level of investment returns can make a significant difference to the profitability of the business.

At present the format of the returns does not require the insurance company to make any allocation of investment income or capital gains to the general insurance business, or to each insurance class. This will probably make it difficult for the Commission to examine this ratio in any depth.

#### *6.2.4.6 Investment Yield*

The ratio of the net investment income earned to the average cash and invested assets over the year

The Investment Yield is an indication of the average return on the company's investments. The yield should be considered in the light of the actual assets held over the period (and the returns obtained in the market over the period).

Analysis should focus on the extent to which speculative investments might have contributed to an unusually low yield – as these types of investment tend to return capital gain rather than income – and the extent to which they are properly valued. Yields may also be reduced by borrowing (including some types of reinsurance) and high investment expenses.

Transactions or investments by/in group undertakings can affect the yield in both ways (higher or lower).

#### *6.2.4.7 Changes in Capital Available*

The change in Capital Available might be regarded as the ultimate measure of the improvement or deterioration in the finances of the company over the year.

A decrease is a cause for concern, but experience has shown that some companies which subsequently went insolvent experienced a large increase in their Core Capital over the preceding period. Large increases might be an indication of instability – and may be indicative of a change in ownership.

### 6.2.5 Reserving

#### *6.2.5.1 Net Technical Provisions / Net Earned Premium*

This ratio should be examined by class of business, and trends over time considered.

Inter-company comparisons may be particularly illuminating. In particular for classes such as motor, it might be expected that the ratio should be similar for different companies. This would be most clearly the case for the compulsory motor insurance that is shared amongst companies, where it might be hoped that the ratios would be similar.

Rapidly expanding companies will tend to have lower ratios, as will newer companies.

The reserving basis for those companies with the lowest reserving ratio as a proportion of net earned premiums should be examined.

#### *6.2.5.2 Net Technical Provisions / Capital Available*

This ratio measures the scale of the company's technical provisions in relation to the size of its capital. The ratio does not address the question of adequacy of reserves but merely looks at the relative scale of the company's operations. In fact, a company which has established conservative provisions may have a high ratio.

It might be worth checking the trend in this ratio. A significant increase might be a cause for concern. Further analysis might focus on reserve for claims currently over 2 years old plus the payments on those claims in the past 2 years against the initial reserve established for those claims.

#### *6.2.5.3 Deterioration (surplus) of original Outstanding Claims Provisions*

This calculation tracks the original outstanding claims provisions made for particular years – against the claims paid and the current provisions. If the latter are higher this indicates that the original provisions were inadequate. Although this may be expected occasionally, a pattern could indicate deliberate under-reserving and a worsening trend might indicate a loosening of the reserving basis.

Forms 21 and 22 may be used to determine these ratios.

#### *6.2.5.4 Estimated Current Deficiency in Provisions / Capital Available*

There may be an estimated deficiency in the provisions held because:

- The actuary has estimated the Reported Claims Provisions using statistical methods, and the results are higher than the those determined by the company using individual Case Estimates
- There is some history of a deterioration of the original outstanding claims provisions, suggesting that the outstanding claims provisions may be inadequate.
- Auditors are not happy with the provisions, and suggest that higher one should be held. In this situation the company should hold the higher provisions required by the auditor, but there may be circumstances where this doesn't take place.
- Technical analysis of the returns provided by the company, and their answers to queries raised suggest that the provisions may be deficient
- As a result of an on-site visit, the Commission believes that the provisions are deficient

As these additional provisions would have to be provided from the Capital Available, this ratio gives an indication of the ability of the company to meet them. Care must be taken if there is any circumstance in which the Capital Available may be covering other contingencies.

### 6.2.6 Expenses

Operating Expenses are all expenses relating to the insurance business, except for claims management expenses. However, the current format of the returns in Jordan does not allow claims management expenses to be separately identified, so that unless the format of the forms is changed the ratio in 6.2.6.4 will be identical to the expenses ratio in 6.2.4.3.

#### *6.2.6.1 Gross Operating Expenses and Commissions Paid / gross written premiums*

Gross Operating Expenses can be found from Forms 5 and 8, and consist of Commissions Paid plus Allocated Administrative Expenses plus Other Expenses.

Gross written premiums are shown in Forms 3 and 6.

#### *6.2.6.2 Net Operating Expenses and Commissions Paid / net written premiums*

Net Operating Expenses are Gross Operating Expenses less Commissions Received.

These allow for the extent that reinsurance commissions help with the company's expenses.

It is possible where most of the risk is reinsured for the reinsurance commissions to exceed the gross operating expenses, and so for the net operating expenses to be negative. It is arguable, in such cases that the insurance company may be really acting more as a broker for the reinsurer, rather than as a risk carrier itself. This practice is reasonable for specialist lines of business, but may not help the development of the insurance market if it extends to more mainstream risk classes.

#### *6.2.6.3 Gross Operating Expenses and Commissions Paid / gross earned premiums*

It is worth analysing the ratio of expenses to earned premiums as well as to written premiums. This is because expenses can be split into three components - acquisition expenses, maintenance expense, and claims management expenses.

In theory acquisition expenses and commissions will be incurred in line with written premiums, whilst maintenance expenses are incurred throughout the term of the contract, and are therefore should be in line with earned premiums.

#### *6.2.6.4 Net Operating Expenses and Commissions Paid / net earned premiums*

As noted above, unless claims management expenses can be separately identified, this will be the same as the expense ratio in 6.2.4.3.

### 6.2.7 Assets

#### *6.2.7.1 Agents' balances / Total Assets*

Agents' balances are the total Accounts Receivable in Form 9 in respect of agents and brokers, less any provisions for doubtful debts.

Total Assets are shown on Form 1. High agent balances can create liquidity problems in paying claims, expenses and reinsurers and may be very difficult to recover for an insurer in financial difficulty.

Agents' balances are also a non-income earning asset; that is the company is effectively losing the interest it could be earning.

#### *6.2.7.2 Agents' balances / Gross Written Premiums*

This ratio measures the length of time (often expressed in days) that it takes to collect premiums from agents.

The ratio should be tracked over time, and comparisons made between other insurance companies. Taking longer to collect debts may be indicative of operational difficulties.

#### *6.2.7.3 Asset Spread*

The ratios that can be examined to consider the spread of assets held by a company include:

- Debt Securities / Total Assets
- Shares and Collective Investments / Total Assets
- Cash and Deposits / Total Assets
- Loans / Total Assets
- Investments in Group undertakings / Total Assets
- Land / Total Assets
- Debtors / Total Asset
- Reinsurers Provisions / Total Assets
- Other Assets / Total Assets

All of these can be taken from Form 31A and 31B.

Any noticeable changes over time should be investigated

Comparisons across the industry should be made, and any companies that are out of line should be looked into.

### 6.3 Life Insurance Business Ratios

#### 6.3.1 New Business

6.3.1.1 *New business index (NBI) = regular premiums + 10% x single premiums*

The New Business index is an internationally accepted measure of the value of business written during the year. The increase over prior year should also be examined. Further division by class and term of business might indicate the source of the new business.

This measure does not give any indication of the adequacy of the premium rates charged for the business.

#### 6.3.2 Expenses

6.3.2.1 *Initial commission ratio = initial commission / NBI*

Although the commissions paid for life insurance are not split between initial commissions and renewal commissions in Form 5, it would be useful if this item could be split to allow the level of the initial commissions paid by each company to be monitored.

6.3.2.2 *Acquisition expense ratio = acquisition expense / NBI*

Acquisition expenses are shown in Form 5.

Comparisons between companies, and changes over time may be of interest

The allocation of company expenses between acquisition and maintenance is not a straightforward exercise, so that anomalies in this ratio may reflect the difficulties in making this allocation rather than underlying problems.

However the Insurance Commission should encourage the Companies it regulates to allocate expenses as well as possible, as an understanding of the expenses within the business is critical to obtaining a good understanding of the underlying business

**Comment [d22]:** Deleted text referred to form 34, which doesn't exist (part of the unadopted life business rules). It might be helpful to leave in a description of this ratio, however.

**Comment [G23]:** This is a comment from GAD.

### 6.3.2.3 *Renewal commission ratio = renewal commission / regular premiums received*

Again, it is recommended that initial and renewal commissions in Form 5 be split.

**Comment [G24]:** This is a comment from GAD.

This ratio is less useful than the measure of initial commission to NBI as it is usually not possible to separate out premiums in the first year, from second year and subsequent premiums.

It may also not be possible to distinguish short term group life and and group credit life premiums on which renewal commissions are not payable.

For a company writing primarily long term individual business, the ratio should be stable over time, and should reflect the level of renewal commission payable.

### 6.3.2.4 *Renewal expense ratio = renewal expenses / regular premiums received*

Renewal or maintenance expense ratios may be a useful inter-company comparison. Lower maintenance expenses are good, particular where expense charges are a fixed percentage of premiums.

However, there are difficulties in the allocation of acquisition and maintenance expenses, as noted in section 6.3.2.2.

In addition, the premium received may not fully correspond to the business to which the maintenance expenses relate.

### 6.3.2.5 *Other management expenses as % of total expenses*

This ratio should be compared across companies and the reasons for any significant variations examined.

## 6.3.3 Persistence

### 6.3.3.1 *Overall exit rate = (off regular premiums from surrenders + lapses + conversions to paid-up)/(regular premiums in force at start of year + 1/2 x new regular premiums)*

Overall exit rates in excess of 10% pa suggest that policyholders are not, in the long term, consistently happy with the product they have purchased.

High exit rates may also be financially disadvantageous for the insurance company, if it was anticipating additional margins arising from the contract.

Factors that can lead to high exit rates include:

- External economic factors such as recession
- Poor sales of unsuitable products
- Churning by agents looking to earn high initial commissions again.
- High charges in early years, so that the company is only concerned about maintaining the policy in force during the first few years.

Lower exit rates lead to individual companies being more stable in the long term.

## 6.3.4 Earnings

Several of these ratios can be difficult to determine from the Jordanian returns because no separate life fund exists.

It may therefore be necessary to replace the long term fund with the mathematical reserves in the following ratios.

#### *6.3.4.1 Yield on long term fund*

This is normally approximated as  $2I / (F_0 + F_1 - I)$  where I = net investment income and capital gains allocated to the long term fund during the year, and  $F_0$  and  $F_1$  are the value of the fund at the beginning and end of the year respectively.

This should be compared with the interest rate used in determining the mathematical reserves. In general, it might be expected that the investment income should cover the interest rates used in the valuation of liabilities by a prudent margin.

The format of the forms makes it difficult to determine the capital gains or losses on the investments backing the life fund or the mathematical reserves.

Form 2 shows capital gains or losses from financial investments to the extent that these pass through an IAS Statement of Income. That includes only financial assets classed as "Financial Assets for Trading". Any capital gains or losses on other financial assets classed as "Available for Sale" or "Held to Maturity" would not be shown in the returns, although it may be possible to determine the gains or losses on Available for Sale Assets from the notes to the accounts.

#### *6.3.4.2 Yield on internal linked funds*

This is normally approximated as  $2I / (F_0 + F_1 - I)$  where I = net investment income and capital gains accruing to the internal linked fund during the year, and  $F_0$  and  $F_1$  are the value of the fund at the beginning and end of the year respectively.

The yield could be compared with the returns expected from that asset class over the time period, based on appropriate benchmarks or the returns obtained by competitors. Consistently lower returns might indicate higher expenses, or poor investment performance – which might lead to a loss of business and higher future expenses. Evidence of irregular deviations from the benchmark might indicate that the investment mandate is not being followed and policyholders are being exposed to more risk than might be expected. The return should also be compared to the change in the unit price as the results should be similar. Any large discrepancies should be investigated.

#### *6.3.4.3 Underwriting Profit (Loss) / Average Life Technical Provisions during the year*

The size of this ratio is likely to be different depending on the mix of business written by the company.

The underwriting profit may be highest as a proportion of the provisions of short term business such as group life and credit life.

Longer-term business will build up larger mathematical provisions over time, so that underwriting profits will tend to be a smaller proportion of the provisions.

The ratio is most useful in comparing companies with similar asset mixes, or in looking at reasonably homogenous classes of business.



## 7 ANALYSIS OF RETURNS AND ACCOUNTS

### 7.1 Overview/purpose of this section of the manual

In analysing a company's returns, the main **aims** of the Commission should be:

- to form a view as to the overall solvency position of the company, including whether the company met the solvency ratio required at all times during the financial year in question;
- to form a view as to the overall strength of the company's reserving methods and assumptions;
- to assess the risks inherent in the company's business, the impact of these risks on the ability of the Commission to meet its overall objectives and the likelihood of the risks occurring;
- in particular, to form a view as to whether the company is likely to be able to continue to maintain its solvency ratio in the future; and
- to determine whether the returns comply with the statutory requirements, and with any undertakings given by the company.

The purpose of this section of the manual is to identify the information contained within the returns which the Commission is likely to find most useful in achieving these aims. After some general considerations, set out in sub-sections 7.2 to 7.5 below, the remaining sub-sections look at each form in turn, highlighting issues the Commission may wish to consider as part of their analysis of the returns.

Detailed information regarding the issues involved in the risk assessment of insurance companies has been given in **section 4** of this manual, and it is not intended to repeat this here. However, in the sub-sections below for each individual form, reference is made to the information which the Commission is likely to use in making such a risk assessment.

In a similar way, **section 5** of this manual outlines techniques which may be used by the Commission, to assess the adequacy of reserves held by an insurance company. Again, it is not intended to repeat this here, but reference is made, in the sub-sections below for each individual form, to information contained in the returns, which is likely to be relevant to an assessment of the adequacy of reserves.

Some key ratios have been specified in **section 6**. Reference will be made to these ratios within the detailed investigation of each form below.

### 7.2 Completeness and correction of returns

An initial check should be carried out when the returns are received, to ensure they are complete. This check should include the following:

- Are all the relevant forms present?
- Are the life and general actuary's certificates both present?

Where any of the required forms are missing, the company should be asked to submit them without delay, so that the analysis of returns can proceed.

The staff of the Commission are responsible for examining in detail the returns of insurance companies. The commission may seek the services of external consultants to assist in evaluating the returns, and may be able to rely on those consultants for some of the more technical aspects of the supervisory process.

Normally, all non-trivial errors and omissions should be drawn to the company's attention. However, in some cases it may not be clear whether an apparent discrepancy is an error or not. In these circumstances, it may be appropriate initially to ask the company for an explanation, or for additional information. The Commission may have further questions to raise, regarding other aspects of the analysis of returns (for example, the adequacy of reserves, or the risks inherent in the company's business), and the company's response to such questions may bring other errors to light.

In most cases, it is likely that the Commission will write to the company regarding all the issues arising from the analysis of its returns, including errors and omissions, once that analysis is complete. There may be exceptions to this however. For example, if an issue of major concern is identified, such as a company which does not meet its solvency ratio, then it may be best to raise this immediately, even though the full analysis has not been completed, and other issues may arise subsequently.

Once errors and omissions have been identified, the objective of the Commission should be to secure the correction of material errors and material omissions in the returns and, if necessary the accounts. The returns are not in the public domain.

Supervisors should have few reservations about formally requesting companies to submit missing information, or to resubmit incorrect information, at any stage of the scrutiny process.

Supervisors should, however, apply the principle of materiality. Corrections need not be sought for minor errors, which are immaterial to the returns as a whole. Whether any particular error or omission is material, or not, is a matter of judgement. Supervisors may find it helpful to consider whether the error or omission presents a materially misleading or incomplete view of the company, or its financial position. In particular, any error or omission which affects the reported solvency position of the company should be regarded as material.

Any documents which are resubmitted (or submitted for the first time) should be checked carefully, in relation to the returns as a whole. Supervisors should also check that the documents are signed, and that the information has been audited, where this is required.

There is a danger that the whole process of analysing the returns, obtaining additional information and explanation from the company, and (if necessary) ensuring the correction of material errors and omissions, can become very lengthy. It is recommended best practice that any request for additional information or explanation from the company, and any requirement for a document to be submitted or resubmitted, should be accompanied by a **timescale**, within which the company is expected to respond. It is further recommended that, where necessary, companies are **chased** for their response, so that the momentum of the process is maintained and repetition of errors can be reduced.

### **7.3 Examining the Returns: an overview**

#### **7.3.1 Introduction**

The remaining subsections of this part of the manual cover in turn each of the forms and certificates contained in the returns, highlighting the checks which may be made, and the issues which the Commission may wish to consider, as part of its analysis of the returns. For life companies, the more detailed of these considerations may be carried out by independent actuarial advisors in their scrutiny of the returns.

Guidance and instructions for the completion of each form are contained in the Guidance for Insurance Companies. It is not intended to reproduce the guidance or instructions in the subsections which follow. However, where it is possible to check compliance with the instructions, either directly from other information contained in the returns, or by means of a “reasonableness check” on the data shown, this has been noted for each form. Also, where the instructions require a supplementary note to be included, this has been highlighted.

The following subsections have a common structure, with the following standard sub-headings:

- Purpose
- Cross-references
- Supplementary notes
- Other points to check
- Other considerations

These are designed to provide the Commission with a checklist of issues to consider on each form. To avoid unnecessary duplication, the purpose of each of these standard subsections is explained below.

#### **7.3.2 Purpose**

This section briefly sets out the purpose of the form and a general description of the information it contains.

#### **7.3.3 Cross references**

This section lists items contained in the form that should cross-reference with items shown in other forms, as provided in the guidance and instructions to the form, or otherwise.

It is recommended best practice that the Commission checks these cross-references, and considers raising any non-compliance with the company. In general, all instances of non-compliance should be raised, except those which are trivial and of no regulatory concern.

The Commission should also consider formally requiring the company to correct any errors identified. In doing so, it should take into account the materiality of the error, and the extent to which it gives rise to an incomplete or inaccurate view of the company’s financial position.

#### 7.3.4 Supplementary notes

This section lists the supplementary notes that are required in connection with this form under the Guidance.

It is recommended best practice that the Commission checks whether all of these have been provided, and their content, and considers raising any omissions, or any concerns which it may have, with the company. In general, all omissions or errors which constitute non-compliance should be raised, except those which are trivial and of no regulatory concern.

The Commission should also consider formally requiring the company to correct any errors or omissions identified. In doing so, it should take into account the materiality of the error, and the extent to which it gives rise to an incomplete or inaccurate view of the company's financial position.

#### 7.3.5 Other points to check

This section lists other points that it is recommended best practice for the Commission to check, and which could lead to a question being put to the company, or to a correction being required.

Checks on the correct submission of multiple forms (for example, for each accounting class) have been included here, although in practice it is likely that this will have been checked at a much earlier stage, soon after receipt of the returns.

#### 7.3.6 Other considerations

This section lists other issues that it is recommended best practice for the Commission to consider, and in particular those which are relevant to the **aims** set out in **section 7.1** above. Such consideration may well lead to further information or explanation being sought from the company.

Where appropriate, reference is made to any information contained within (or which may be derived from) each form, which is particularly relevant to one or other aspect of the **risk assessment** for the company. These relate to the "indicators of risk" which are set out in **section 4.6** of this manual.

### 7.4 **Outline of Forms in the Returns and Accounts**

The returns and accounts submitted use a different numbering system dependent on whether the company is a Composite, a pure General Insurer, a pure Life Insurer or an Islamic company. The next section (7.5) sets out the differences between the numbering and the forms.

Unless otherwise specified **all** Form numbers used in this manual refer to Composite returns and accounts.

**Comment [d25]:** These two paragraphs are extremely confusing, and the table doesn't seem to help. Some of the forms carry the same # regardless of which type of company; some are different.

## 7.5 Returns and Accounts Requirements

### 7.5.1 By Type of Company

		Life	General	Composite	Is
<b>7.6</b>	<b>Solvency Margin Forms</b>				
	Annex (1) Solvency Margin	Yes	Yes	Yes	
	Annex (2) Capital Available	Yes	Yes	Yes	
	Annex (3) Capital Required for Assets Risks	Yes	Yes	Yes	Yes
	Annex (4) Capital Required for General Insurance Policy Liabilities	Yes - 1	Yes	Yes	Yes
	Annex (5) Capital Required / Capital Deduction for Reinsurance Ceded Risks (General Insurance)	No	Yes	Yes	Yes
	Annex (6) Capital Required for Life Assurance Risks	Yes	No	Yes	Yes
<b>7.7</b>	<b>Company Level Accounts</b>				
	Form 1 Balance Sheet	Yes	Yes	Yes	Yes
	Form 2 Statement of Income	Yes	Yes	Yes	No
	Accounts Balance Sheet	Yes	Yes	Yes	Yes
	Accounts Statement of Income	Yes	Yes	Yes	Yes
	Accounts Statement of Changes in Shareholders Equity	Yes	Yes	Yes	Yes
	Accounts Cash Flow Statement	Yes	Yes	Yes	Yes
	Form 2 Statement of Income for Islamic Insurers	No	No	No	Yes
<b>7.8</b>	<b>Life Business – Profit and Loss Account</b>				
	Form 3 Life Underwriting Revenue	Yes	No	Yes	Yes
	Form 4 Life Cost of Claims	Yes	No	Yes	Yes
	Form 5 Life Underwriting Profit and Loss Account	Yes	No	Yes	Yes
	Accounts Life Underwriting Revenue	Yes	No	Yes	Yes
	Accounts Life Cost of Claims	Yes	No	Yes	Yes
	Accounts Life Underwriting Profit and Loss Account	Yes	No	Yes	Yes
<b>7.9</b>	<b>General Business – Profit and Loss Account</b>				
	Form 3 Non-Life Underwriting Revenue	No	Yes	Yes	Yes
	Form 4 Non-Life Cost of Claims	No	Yes	Yes	Yes
	Form 5 Non-Life Underwriting Profit and Loss Account	No	Yes	Yes	Yes
	Accounts Non-Life Underwriting Revenue	No	Yes	Yes	Yes
	Accounts Non-Life Cost of Claims	No	Yes	Yes	Yes
	Accounts Non-Life Underwriting Profit and Loss Account	No	Yes	Yes	Yes
	??Motor Insurance Profit and Loss Forms - Introduction				
	Form 1, 11 Underwriting Revenue Account Breakdown of Motor Business	No	Yes - 2	Yes - 2	Yes - 2
	Form 12 Motor Cost of Claims	No	Yes - 2	Yes - 2	Yes - 2
	Form 13, also 16 Motor Underwriting Profit and Loss Account	No	Yes - 2	Yes - 2	16Yes - 2
<b>7.10</b>	<b>Debt Analysis</b>				
	Form 6, also 9 Account Receivable	Yes	Yes	Yes	Form 9

**Comment [d26]:** This entire table needs to be verified by Commission as revised. The original author only cited forms used for Composite cos., but 4 columns of table are to show type of company using the form, so it's confusing. Some of the forms originally referenced don't exist and so were deleted. Finally, the Decision document on the website has two sections for "Islamic cos. Licensed to write both life and general" and no section for Composite.

**Comment [d27]:** It appears as though a proposed re-numbering of forms hasn't happened. In the Instructions and Decisions, Forms 3-5 have same numbering and title whether for life or general business.

	Form 7, also 10	Due from Other Insurers	Yes	Yes	Yes	10
	Form 8, also 11	Receivable Notes and Post-Dated Cheques	Yes	Yes	Yes	11
	Form 9, also 12	Over-due loans instalments	Yes	Yes	Yes	12
<b>7.11</b>	<b>Invested Asset Analysis</b>					
	Form 10, also 13	Property Investments	Yes	Yes	Yes	13
	Form 11A/B, 14 A/B, 17A/B	Financial Assets for Trading	Yes	Yes	Yes	Yes
	Form 12A/B/C/15 A/B/C, 18A/B	Available for Sale Financial Assets	Yes	Yes	Yes	Yes
	Form 13/16, 19	Held to Maturity Investments	Yes	Yes	Yes	Yes
	Form 14,17, 20	Investments in Subsidiaries & Associates	Yes	Yes	Yes	Yes
<b>7.12</b>	<b>Claims Analysis</b>					
	Form 18 and 21	Claims Settlement Analysis	No	Yes	Yes	21
	Form 21, 22	Claims Details Analysis	No	Yes	Yes	22
	Form 26, also 23	Motor Claims Details	No	Yes - 2	Yes - 2	Yes - 2
<b>7.13</b>	<b>Life Business Information</b>					
	Form 19, also 27	Underwriting Analysis	Yes	No	Yes	27Yes
	<b>Form 28: company life insurance balance sheet</b>				Yes?	Yes
<b>7.15</b>	<b>Miscellaneous Forms</b>					
	Form 20, also , 29	Distribution Channels	Yes	Yes	Yes	Yes
	Form 22, also 25, 30	Concentration of Policies	Yes	Yes	Yes	Yes
<b>7.16</b>	<b>Reinsurance</b>					
	Form 16-A/B: General Insurance Business: Summary of Treaty Reinsurance Business Ceded; note: also Form 20 A/B, and 23A/B					
	Form 17 General Insurance Business: Summary of Facultative Reinsurance Business Ceded; note also Form 21 and 24					
	Form 18 General Insurance Business: Summary of Treaty and Facultative Reinsurance; note also Form 22 and 25					
<b>7.17</b>	<b>Life Actuary's Certificate</b>					
	Certificate		Yes	No	Yes	Yes
<b>7.18</b>	<b>General Actuary's Certificate</b>					
	Certificate		Yes - 4	Yes	Yes	Yes

**Comment [d28]:** It would appear that form 16 A/B should be for life insurance, since it's in the section dealing with life licensed companies, but in fact the title of both 16 and 20 says "General Insurance". Same holds for next two rows.

Where:

"Yes - 1" = A life company should complete the Solvency Margin Annex (4) Capital Required for General Insurance Policy Liabilities in respect of any Medical Expenses Business, any IBNR provisions and any Additional Assurances.

"Yes - 2" = Motor insurance forms need only be completed by companies writing motor business

"Yes - 3" = Forms in respect of Investment-Linked business or Group Pensions Funds Management business need only be completed by companies writing this business.

#### 7.5.2 Frequency that Forms are Required

**Comment [d29]:** Same problems apply here as to the table above. Rather than reinvent the wheel, suggest reproducing table from p. 2 of Decision #2, 2003--shows frequency of form submission. However, it does appear to be helpful to break down the forms by topic and title, rather than just using Form #s.

	<b>THIS TABLE NOT EDITED. This is also duplicative. Could revise table above to add columns showing filing frequency, and then wouldn't have to repeat the whole list.</b>	Quarterly	Half- Yearly	Annual
<b>7.6</b>	<b>Solvency Margin Forms</b>			
	Annex (1) Solvency Margin	Yes		
	Annex (2) Capital Available	Yes		
	Annex (3) Capital Required for Assets Risks	Yes		
	Annex (4) Capital Required for General Insurance Policy Liabilities	Yes		
	Annex (5) Capital Required / Capital Deduction for Reinsurance Ceded Risks (General Insurance)	Yes		
	Annex (6) Capital Required for Life Assurance Risks	Yes		
	Annex (7) Capital Required for Interest Rate Risks (Life Assurance)	Yes		
<b>7.7</b>	<b>Company Level Accounts</b>			
	Form 1 Balance Sheet	Yes		
	Form 2 Statement of Income	Yes		
	Accounts Balance Sheet			Yes
	Accounts Statement of Income			Yes
	Accounts Statement of Changes in Shareholders Equity			Yes
	Accounts Cash Flow Statement			Yes
	Form 2 Statement of Income for Islamic Insurers	Yes		
<b>7.8</b>	<b>Life Business – Profit and Loss Account</b>			
	Form 3 Life Underwriting Revenue	Yes		
	Form 4 Life Cost of Claims	Yes		
	Form 5 Life Underwriting Profit and Loss Account	Yes		
	Accounts Life Underwriting Revenue			Yes
	Accounts Life Cost of Claims			Yes
	Accounts Life Underwriting Profit and Loss Account			Yes
<b>7.9</b>	<b>General Business – Profit and Loss Account</b>			
	Form 6 Non-Life Underwriting Revenue	Yes		
	Form 7 Non-Life Cost of Claims	Yes		
	Form 8 Non-Life Underwriting Profit and Loss Account	Yes		
	Accounts Non-Life Underwriting Revenue			Yes
	Accounts Non-Life Cost of Claims			Yes
	Accounts Non-Life Underwriting Profit and Loss Account			Yes
	Motor Insurance Profit and Loss Forms - Introduction			
	Form 14 Motor Underwriting Revenue	Yes		
	Form 15 Motor Cost of Claims	Yes		
	Form 16 Motor Underwriting Profit and Loss Account	Yes		
<b>7.10</b>	<b>Debt Analysis</b>			
	Form 9 Accounts Receivable		Yes	
	Form 10 Due from Other Insurers		Yes	
	Form 11 Receivable Notes and Post-Dated Cheques		Yes	

	Form 12	Over-due loans instalments		Yes	
<b>7.11</b>	<b>Invested Asset Analysis</b>				
	Form 13	Property Investments		Yes	
	Form 17A/B	Financial Assets for Trading		Yes	
	Form 18A/B/C	Available for Sale Financial Assets		Yes	
	Form 19	Held to Maturity Investments		Yes	
	Form 20	Investments in Subsidiaries & Associates		Yes	
	Form 31A/B	Schedule of approved investments and other assets		Yes	
	Form 31C	Summary schedule of approved investments and Other assets		Yes	
<b>7.12</b>	<b>Claims Analysis</b>				
	Form 21	Claims Settlement Analysis			Yes
	Form 22	Claims Details Analysis		Yes	
	Form 26	Motor Claims Details		Yes	
<b>7.13</b>	<b>Life Business Information</b>				
	Form 34	Analysis of New Individual Life Business			Yes
	Form 35	Analysis of Life Business Claims			Yes
	Life Actuary Report	Appendix 4 - Summary of Changes in Individual Business			Yes
<b>7.14</b>	<b>Investment-Linked Life Business Accounts</b>				
	Form 32	Summarised Balance Sheet for Internal Linked Fund			Yes
	Form 33	Revenue Account for Internal Linked Fund			Yes
<b>7.15</b>	<b>Miscellaneous Forms</b>				
	Form 29	Distribution Channels	Yes		
	Form 30	Concentration of Policies		Yes	
<b>7.16</b>	<b>Life Valuation Summaries</b>				
	Life Actuary Report	Appendix 1 - Valuation summary of Non-linked Life contracts			Yes
	Life Actuary Report	Appendix 2 - Valuation summary of investment-linked contracts			Yes
	Life Actuary Report	Appendix 3 - Valuation summary of Group Pension Funds Management contracts			Yes
<b>7.17</b>	<b>Reinsurance</b>				
	Life Actuary Report	Appendix 5 - Proportional Treaty Reinsurance			Yes
	Life Actuary Report	Appendix 6 - Facultative Reinsurance			Yes
	Life Actuary Report	Appendix 7 - Non-Proportional Reinsurance			Yes
	Life Actuary Report	Appendix 8 - List of Reinsurers			Yes
	General Actuary Report	Appendix 1 - Proportional Treaty Reinsurance			Yes
	General Actuary Report	Appendix 2 - Facultative Reinsurance			Yes
	General Actuary Report	Appendix 3 - Non-Proportional Reinsurance			Yes
	General Actuary Report	Appendix 4 - List of Reinsurers			Yes
<b>7.18</b>	<b>Abstract of the Life Actuary's report</b>				



	Abstract of valuation report			Yes
<b>7.19</b>	<b>Abstract of the General Actuary's report</b>			
	Abstract of valuation report			Yes
<b>7.20</b>	<b>Life Actuary's Certificate</b>			
	Certificate			Yes
<b>7.21</b>	<b>General Actuary's Certificate</b>			
	Certificate			Yes

### 7.5.3 Forms Requirements by Location

		Branch	Global	Global Consolidated
	<b>NOT EDITED</b> > SAME comment as above—there should be one table. P. 2 of Decision #2, 2003 organizes forms by both filing date and location basis.			
<b>7.6</b>	<b>Solvency Margin Forms</b>			
	Annex (1) Solvency Margin	Yes	Yes	Yes
	Annex (2) Capital Available	Yes	Yes	Yes
	Annex (3) Capital Required for Assets Risks	Yes	Yes	Yes
	Annex (4) Capital Required for General Insurance Policy Liabilities	Yes	Yes	Yes
	Annex (5) Capital Required / Capital Deduction for Reinsurance Ceded Risks (General Insurance)	Yes	Yes	Yes
	Annex (6) Capital Required for Life Assurance Risks	Yes	Yes	Yes
	Annex (7) Capital Required for Interest Rate Risks (Life Assurance)	Yes	Yes	Yes
<b>7.7</b>	<b>Company Level Accounts</b>			
	Form 1 Balance Sheet	Yes	Yes	No
	Form 2 Statement of Income	Yes	Yes	No
	Accounts Balance Sheet	Yes	?	?
	Accounts Statement of Income	Yes	?	?
	Accounts Statement of Changes in Shareholders Equity	Yes	?	?
	Accounts Cash Flow Statement	Yes	?	?
<b>7.8</b>	<b>Life Business – Profit and Loss Account</b>			
	Form 3 Life Underwriting Revenue	Yes	Yes	No
	Form 4 Life Cost of Claims	Yes	Yes	No
	Form 5 Life Underwriting Profit and Loss Account	Yes	Yes	No
	Accounts Life Underwriting Revenue	Yes	?	?
	Accounts Life Cost of Claims	Yes	?	?
	Accounts Life Underwriting Profit and Loss Account	Yes	?	?
<b>7.9</b>	<b>General Business – Profit and Loss Account</b>			
	Form 6 Non-Life Underwriting Revenue	No	Yes	No
	Form 7 Non-Life Cost of Claims	No	Yes	No
	Form 8 Non-Life Underwriting Profit and Loss Account	No	Yes	No
	Accounts Non-Life Underwriting Revenue	Yes	?	?

	Accounts	Non-Life Cost of Claims	Yes	?	?
	Accounts	Non-Life Underwriting Profit and Loss Account	Yes	?	?
	Motor Insurance Profit and Loss Forms - Introduction				
	Form 14	Motor Underwriting Revenue	Yes	No	No
	Form 15	Motor Cost of Claims	Yes	No	No
	Form 16	Motor Underwriting Profit and Loss Account	Yes	No	No
<b>7.10</b>	<b>Debt Analysis</b>				
	Form 9	Accounts Receivable	Yes	Yes	Yes
	Form 10	Due from Other Insurers	Yes	Yes	Yes
	Form 11	Receivable Notes and Post-Dated Cheques	Yes	Yes	Yes
	Form 12	Over-due loans instalments	Yes	Yes	Yes
<b>7.11</b>	<b>Invested Asset Analysis</b>				
	Form 13	Property Investments	Yes	Yes	Yes
	Form 17A/B	Financial Assets for Trading	Yes	Yes	Yes
	Form 18A/B/C	Available for Sale Financial Assets	Yes	Yes	Yes
	Form 19	Held to Maturity Investments	Yes	Yes	Yes
	Form 20	Investments in Subsidiaries & Associates	Yes	Yes	Yes
	Form 31A/B	Schedule of approved investments and other assets	Yes	Yes	Yes
	Form 31C	Summary schedule of approved investments and Other assets	Yes	Yes	Yes
<b>7.12</b>	<b>Claims Analysis</b>				
	Form 21	Claims Settlement Analysis	Yes	Yes	No
	Form 22	Claims Details Analysis	Yes	Yes	No
	Form 26	Motor Claims Details	Yes	No	No
<b>7.13</b>	<b>Life Business Information</b>				
	Form 34	Analysis of New Individual Life Business	Yes	No	No
	Form 35	Analysis of Life Business Claims	Yes	No	No
	Life Actuary Report	Appendix 4 - Summary of Changes in Individual Business	Yes	No	No
<b>7.14</b>	<b>Investment-Linked Life Business Accounts</b>				
	Form 32	Summarised Balance Sheet for Internal Linked Fund	Yes	No	No
	Form 33	Revenue Account for Internal Linked Fund	Yes	No	No
<b>7.15</b>	<b>Miscellaneous Forms</b>				
	Form 29	Distribution Channels	Yes	Yes	No
	Form 30	Concentration of Policies	Yes	Yes	No
<b>7.16</b>	<b>Life Valuation Summaries</b>				
	Life Actuary Report	Appendix 1 - Valuation summary of Non-linked Life contracts	Yes	No	No
	Life Actuary Report	Appendix 2 - Valuation summary of investment-linked contracts	Yes	No	No
	Life Actuary Report	Appendix 3 - Valuation summary of Group Pension Funds Management contracts	Yes	No	No
<b>7.17</b>	<b>Reinsurance</b>				
	Life Actuary Report	Appendix 5 - Proportional Treaty	Yes	No	No

	Reinsurance			
	Life Actuary Report Appendix 6 - Facultative Reinsurance	Yes	No	No
	Life Actuary Report Appendix 7 - Non-Proportional Reinsurance	Yes	No	No
	Life Actuary Report Appendix 8 - List of Reinsurers	Yes	No	No
	General Actuary Report Appendix 1 - Proportional Treaty Reinsurance	Yes	No	No
	General Actuary Report Appendix 2 - Facultative Reinsurance	Yes	No	No
	General Actuary Report Appendix 3 - Non-Proportional Reinsurance	Yes	No	No
	General Actuary Report Appendix 4 - List of Reinsurers	Yes	No	No
<b>7.18</b>	<b>Abstract of the Life Actuary's report</b>			
	Abstract of valuation report	Yes	No	No
<b>7.19</b>	<b>Abstract of the General Actuary's report</b>			
	Abstract of valuation report	Yes	No	No
<b>7.20</b>	<b>Life Actuary's Certificate</b>			
	Certificate	Yes	No	No
<b>7.21</b>	<b>General Actuary's Certificate</b>			
	Certificate	Yes	No	No

## 7.6 Solvency Margin Forms

### 7.6.1 Purpose

The solvency margin forms are intended to demonstrate the calculation of the Capital Available, the Capital Required and the Solvency Ratio for the insurance company.

Insurance companies are required to have the Solvency Ratio of Capital Available to Capital Required in excess of 150%.

The Risk Based Capital approach to the determination of the solvency margin calculation is described in Section 3 of this manual.

- *Forms included*

The Solvency Margin forms are shown in the Solvency Margin Instructions (No. 3 of 2002) and interpretation is given in the Guidelines for the Solvency Margin Instructions (Decision No. 5 of 2002).

These are:

Annex (1)	Solvency Margin
Annex (2)	Capital Available
Annex (3)	Capital Required for Assets Risks
Annex (4)	Capital Required for Policy Liabilities
Annex (5)	Capital Required for Reinsurance Ceded Risks
Annex (6)	Capital Required for Life Assurance Risks

### 7.6.1.2 Required Frequency

All Solvency Margin forms are required quarterly

## 7.6.2 Annex (1) – Solvency Margin

### 7.6.2.1 Purpose

This form summarises the risk-based Capital Requirements, identifies the company's Capital Available (in excess of liabilities) and calculates the Solvency Ratio.

### 7.6.2.2 Cross references

1.	Capital Available = Corresponding item on Annex (2)
2.	Capital Required for Asset Risks = Corresponding item on Annex (3)
3.	Capital Required for Policy Liabilities = Corresponding item on Annex (4)
4.	Capital Required for Reinsurance Ceded Risks = Corresponding item on Annex (5)
5.	Capital Required for Life Assurance Risks = Corresponding item on Annex (6)

### 7.6.2.3 Supplementary notes

1.	Reason for any difference between amounts shown as at the previous quarter end and the corresponding amounts as at the current quarter end for the previous quarter (other than differences as a result of currency movements)
----	--

### 7.6.2.4 Other points to check

Do the amounts shown as at the previous quarter end agree with those shown in at the current quarter end for the previous quarter? If not, is there a supplementary note giving a valid explanation, or could the differences reasonably result from currency movements?

### 7.6.2.5 Other considerations

The following points should also be considered:

- Are there any concerns over compliance with the asset valuation and admissibility rules, or over the adequacy of reserves held, which might mean that the level of solvency shown in this form is overstated?
- Is the Solvency Ratio less than 150%? If so, the Director General should require the company to submit a plan for financial restoration.
- Is the Solvency Ratio less than 120%? If so, the Director General should require the company to submit a short term finance scheme.

- Is the Solvency Ratio less than **xxx**%? (there is no clear level that should definitely trigger rehabilitation, and we suggest that each case be considered on its merits). If so, the Director General should consider rehabilitating the company.

The following information is relevant to **capital risk**:

- Is the amount of Capital Available over the Capital Required negative, low or reducing?

The following ratios may be derived from this form:

- Solvency Ratio
- Cover for Minimum Solvency Margin

### 7.6.3 Annex (2) - Capital Available

#### 7.6.3.1 *Purpose*

This Annex sets out the calculation of the Capital Available. A detailed description of the method of calculation of the Capital Available has been given in **section 4.3** of the Guidance for Insurance Companies and this will not be repeated here.

### 7.6.3.2 Cross references

1.	Paid up Share Capital (excluding cumulative share capital) plus the cumulative preference share capital should equal the total paid up share capital plus preference share capital in Form 1.
2.	Statutory Reserves, Voluntary Reserves and Other Reserves should equal the corresponding items in Form 1.
3.	Premiums on issued shares and Premiums on Treasury Stock less Discount on Issued Shares should equal Premiums (Discounts) plus Premiums on Treasury Stocks in Form 1.
4.	Retained Earnings or Accumulated losses equal the corresponding item in Form 1.
5.	Minority Interest should only be for the consolidated version of this Annex, where non-insurance subsidiaries have been included. It should equal the corresponding entry in the consolidated Form 1 Balance sheet.
6.	Treasury stock should equal the corresponding item in Form 1.
7.	The Exposure to Group Four Reinsurers should equal the corresponding item in Annex (5).
8.	Changes in Fair Value (Available for Sale) should equal the corresponding entry in Form 1
9.	Foreign Currency Translation should equal the corresponding entry in Form 1.

### 7.6.3.3 Supplementary notes

None.

### 7.6.3.4 Other points to check

Note: the Deficit in Provision and Technical Provisions item has no corresponding item in Form 1.

### 7.6.3.5 Other considerations

None.

## 7.6.4 Annex (3) - Capital Required for Asset Risks

### 7.6.4.1 Purpose

This Annex sets out the calculation of the Capital Required for Asset Risks. A detailed description of the method of calculation of the Capital Required for Asset Risks has been given in **section 3.4** of this manual and this will not be repeated here.

## 7.6.4.2 Cross references

1.	The Book Value of Accrued Revenue should equal leave reference to this figure even though forms not in force??These are contained in the Other Assets item on Form 1, and should be identified in note 16 to the accounts.
2.	The Book Value of Prepaid expenses should equal leave reference to this figure even though forms not in force??These are contained in the Other Assets item on Form 1, and should be identified in note 16 to the accounts.
3.	The Book Values of the Accounts Receivable, split by when they were due, should equal the corresponding items on Form 9.
4.	The Book Value of the Local Insurers Receivable should equal the total local insurers receivable, less any bad debt provisions, shown in Form 10.
5.	The Book Value of the Group One Foreign Reinsurers Receivable plus the Reinsurers receivable in Column 5 of Part One and Part Two shown on Annex (5), the Capital Required for Reinsurance Ceded Risks, should equal the total reinsurers receivable, less any bad debt provisions, shown in Form 10.
6.	The Book Value of the Group One Reinsurers' UPP plus the total of the Reinsurers' UPP in Column 2 of Part One and Part Two, shown in Annex (5) the Capital Required for Reinsurance Ceded Risks, should equal the total reinsurers' share of the UPP shown in Form 6.
7.	The Book Value of the Group One Reinsurers' OCP plus the total of the Reinsurers' OCP in Column 3 of Part One and Part Two, shown in Annex (5) the Capital Required for Reinsurance Ceded Risks, should equal the total reinsurers' share of the OCP shown in Form 7.
8.	The Book Value of Other Recoverables on Unpaid claims should equal the total net Subrogation on Form 4 plus the total net Salvage and Subrogation on Form 7.
9.	The Book Value of Receivable Notes and Post-Dated Cheques should equal the corresponding values on Form 11.
10.	The total Book Value of the Bank Deposits should equal Deposits with banks in Form 1.
11.	The Book Values of Trading Securities should equal the total Fair Values in Forms 17A and 17B. The total should equal the total Financial Assets for Trading shown in Form 1.
12.	The Book Values of Available for Sale Securities should equal the total Fair Values in Forms 18A, 18B and 18C. The total should equal the total Available for Sale Financial Assets for Trading shown in Form 1.
13.	The Book Values of Held to Maturity Bonds should equal the total carrying values in Form 19. The total should equal the total Held to Maturity Bonds investments shown in Form 1.

14.	The Book Value of Property Investments should be identifiable in Form 13. The total should equal the total Property Investments shown in Form 1.
15.	The Admissible Value of any investment in financial? Subsidiaries and Associates should be zero.  The Book Value of any investment in Subsidiaries and Associate should equal the carrying values shown in Form 20, and the total shown in Form 1.
16.	Life policy loans not exceeding the surrender value the book value should equal the admissible value.  The admissible value of any life policy loans exceeding the surrender value should be zero.  Similarly the book values should equal the IAS values on Forms 31A and 31B, and the corresponding entries in Form 12 and Form 1.
17.	The book values should equal the corresponding entries in Form 12 and Form 1.
18.	The book values should equal the corresponding entries in Form 12 and Form 1.
19.	The book values should equal the corresponding entries in Form 12 and Form 1.
20.	The Book Value of Other Investments should equal the corresponding entry in Form 1.
21.	The Book Value of Property for Own Use should be identifiable on Form 13.
22.	The Book Value of Other Assets, Tangible, intangible and other assets plus the real Estate in Fixed Assets should equal the total of the Fixed Assets, Intangible assets and Other Assets in Form 1.

#### 7.6.4.3 *Supplementary notes*

None.

#### 7.6.4.4 *Other points to check*

None.

#### 7.6.4.5 *Other considerations*

None.

### 7.6.5 Annex (4) – Capital Required for General Insurance Policy Liabilities

#### 7.6.5.1 *Purpose*

Annex (4) sets out the calculation of the Capital Required for General Insurance Policy Liabilities. A detailed description of the method of calculation of the Capital Required for General Insurance Policy Liabilities has been given in **section 3.5** of this manual and



this will not be repeated here. However, the key checks which may be made on the calculation are set out below.

A supplementary copy of Annex (4) may be completed for life assurance business.

#### 7.6.5.2 Cross references

1.	Entries in Column 2 = 50% of Net Written Premiums in Form 6
2.	Treaty Reinsurance Accepted in Form 6? (written premium and net UPP)
3.	The Net UPP's in column 3 = Net UPP in Form 6
4.	The Net OCP in column 6 should equal the net OCP in Form 7, for each class of insurance business.
5.	Treaty Reinsurance Accepted in Form 7? (OCP)

The life business version of the Capital Required for Policy liabilities should be completed in respect of:

- Medical Insurance
- Additional Insurances
- The Life Business IBNR provision

Medical Business should be treated identically for capital requirement purposes whether it is written as life or general insurance business.

Additional Insurances and IBNR provisions for life business should be treated as Other General Insurance classes.

#### 7.6.5.3 Supplementary notes

None

#### 7.6.5.4 Other points to check

All calculations should be checked.

All entries in Column 5 must equal the maximum of Column 2 and Column 3 multiplied by the relevant factor in Column 4.

#### 7.6.5.5 Other considerations

None.

### 7.6.6 Annex (5) – Capital Required for Reinsurance Ceded

#### 7.6.6.1 Purpose

This Annex sets out the calculation of the Capital Required for Reinsurance Ceded Risks. A detailed description of the method of calculation of the Capital Required for Reinsurance Ceded Risks has been given in **section 3.6** of this manual and this will not be repeated here.

#### 7.6.6.2 Cross references

1.	The total of the Reinsurers UPP in Column 2 of Part One and Part Two, plus the Group One Reinsurers UPP shown on Annex (3), the Capital Required for Asset Risks, should equal the total reinsurers' share of the UPP shown in Form 6.
2.	The total of the Reinsurers OCP in Column 3 of Part One and Part Two, plus the Group One Reinsurers OCP shown on Annex (3), the Capital Required for Asset Risks, should equal the total reinsurers' share of the OCP shown in Form 7.
3.	The total of the Reinsurers receivable in Column 5 of Part One and Part Two, plus the Group One Foreign Reinsurers Receivable shown on Annex (3), the Capital Required for Asset Risks, should equal the total reinsurers receivable, less any bad debt provisions, shown in Form 10.

#### 7.6.6.3 Supplementary notes

None.

#### 7.6.6.4 Other points to check

The calculations of the totals in column 8 should be checked.

The Capital Required or Capital Deduction in column 10 is the total in column 8 multiplied by the Factor in Column 9. The calculations should be checked.

Amounts payable to reinsurers, but not yet paid are not separately identifiable for Group One reinsurers, and therefore cannot be cross-referenced. However the total amount due to reinsurers is shown in note 20 to the Accounts. It should therefore be checked that this total is at least equal to the amount payable to Group Two, Three and Four reinsurers.

#### 7.6.6.5 Other considerations

Non-owned deposits held as security or for currency/asset matching purposes may not appear elsewhere in the accounts or the returns. There should be a sufficient description given on the operation of such deposits given in the General Actuary's Report or the Appendices to that report. If that is not the case the company should be asked to provide more detail.

The formula used to determine the Capital Requirements and Capital Deductions for Reinsurance Ceded gives Insurance companies a material incentive to increase the "Reinsurer Payable" deduction as far as possible, that is to delay payment of premiums to reinsurer (at least to the extent of the reinsurers' provisions and receivables). In other words the insurance company may wish to defer paying its reinsurance accounts. If the reinsurer payable item looks large as a percentage of premium, it would be worth checking whether the terms of the reinsurance agreement allow the accounts to be delayed, as it is possible if that it is not that case for relationship issues to arise with the reinsurer and for the payment of reinsurance claims to be jeopardised.

## 7.6.7 Annex (6) Capital Required for Life Assurance Risks

### 7.6.7.1 Purpose

This Annex sets out the calculation of the Capital Required for Life Assurance Risks. A detailed description of the method of calculation of the Capital Required for Life Assurance Risks has been given in **section 3.7** of this manual and this will not be repeated here. However, the key checks which may be made on the calculation are set out below.

**Comment [d30]:** Much of 3.7 deleted.

### 7.6.7.2 Cross references

1.	The total of Line 1 and line 5 = the total gross mathematical reserves shown in Form 5 less the gross technical reserves in respect of medical insurance, additional insurances, group business and the IBNR provision in respect of life business.
2.	The total reinsurers reserves in line 2 and 6 = the total reinsurers reserves shown in Form 5 less the reinsured technical reserves in respect of medical insurance, additional insurances, group business and the IBNR provision in respect of life business.

### 7.6.7.3 Supplementary notes

1.	Any individual contracts where the mathematical reserves are higher than the sum insured, such as annuity or pure endowment policies should be identified, and the net sum at risk in line 11 adjusted.
2.	Any other adjustments in the sum at risk calculation in line 11, such as the elimination of reserves from group contracts from the reserve deducted, should be explained in a note.
3.	If any contracts have a low sum insured relative to the reserves, and are largely reinsured, it is possible for the reinsurers share of the reserve (in lines 2 and 6) to be more than the reinsurers share of the sum insured or individual policies in line 10. This would produce an anomalous result, but would lead to and increase in the solvency margin, so it is not essential for it to be eliminated, but if a company chooses to do so this should be explained in a note.

### 7.6.7.4 Other points to check

All calculations should be checked.

Line 2 should not be more than 15% of line 1.

Line 4 should be calculated as 3% \* line 3.

Line 5 should not be more than 15% of line 4.

Line 8 should be calculated as 3% \* line 7.

Line 10 should not be more than 50% of line 9.

Line 12 should be calculated as 0.15% \* line 11.

Line 14 should not be more than 50% of line 13.

Line 16 should be calculated as 0.15% \* line 15.

**Comment [d31]:** Form only goes to Line 14. Are the rest of the line references and %ages correct?

#### 7.6.7.5 Other considerations

The following points should also be considered, if the Director General has reduced the capital requirement in respect of the reserves for this investment linked business:

**Comment [d32]:** References in following section don't match current Annex 6. Investment linked business doesn't appear to be broken out separately on this form.

- Is the split of investment-linked liabilities between line 1 and 5 consistent with the information available regarding investment guarantees, and restrictions on increases to expense charges, under linked contracts?
- Have all liabilities in respect of investment-linked contracts, other than linked liabilities, been included in line 1?

## 7.7 Company Level Accounts

### 7.7.1 Purpose

These Forms and Accounts present the IAS accounts in a format appropriate for Jordanian insurance companies and Islamic insurers. There are no formal IAS standards for the totality of insurance company accounts but various international accounting standards will apply to certain of the assets and liabilities of the insurance company.

- There are no IAS standards for Technical Provisions and Mathematical Reserves and these may be determined on a prudent statutory basis established by regulators
- Many assets are valued on an IAS basis where there is an applicable standard. This is broadly "Fair Value" for most classes other than bonds that are classed as "Held To Maturity" which are valued at amortised book value, and Property which may be valued as book value less accumulated depreciation if the company so chooses.

IAS accounts are intended to provide a realistic assessment of company's profitability, and as such do not necessarily accord with regulatory requirements for prudent finances. IAS accounts cannot be regarded as truly prudential.

Since the IAS accounts are of limited value in trying to assess the solvency of the company, the comments in this section will be kept brief.

### 7.7.2 Forms in this Category

There are 2 Forms in the returns, and 4 Forms in the Accounts:

Form 1	Balance Sheet
Form 2	Statement of Income
Accounts	Balance Sheet
Accounts	Statement of Income
Accounts	Statement of Changes in Shareholders' Equity
Accounts	Cash Flow Statement

In addition Form 2 for Islamic Insurers is distinct.

Form 2      Statement of income – Islamic Insurers

This is the only Form that differs from the equivalent Composite insurance forms.

7.7.3 Required Frequency

Forms 1 and 2 are required on a quarterly basis.

The IAS Accounts are required annually.

7.7.4 Form 1 - Balance Sheet

7.7.4.1 *Purpose*

This form summarises the assets on an IAS basis and the liabilities of the company on a prudent or solvency basis

7.7.4.2 *Cross references*

The cross-references to Form 1 are shown in the sections of this manual relating to other forms or Solvency Margin Annexes

7.7.4.3 *Supplementary notes*

None.

7.7.4.4 *Other points to check*

Do the amounts shown for the Previous Period agree with those shown for the Current Period for the prior period? If not, is there a supplementary note giving a valid explanation, or could the differences reasonably result from currency movements?

7.7.4.5 *Other considerations*

None

7.7.5 Form 2 – Statement of Income

7.7.5.1 *Purpose*

This form shows the transfers from or to the revenue accounts for life business and general business, and the other items which make up the profit and loss account for the company.

7.7.5.2 *Cross references*

1.	The total of Underwriting Profit (loss) inside and outside Jordan, should equal
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	the sum of the Underwriting Profit (Loss) in Forms 5 and 8.
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#### 7.7.5.3 *Supplementary notes*

1.	Reason for any difference between amounts shown for the Pervious Period and the corresponding amounts for the Current Period for the prior period (other than differences as a result of currency movements)
2.	(For a composite company only) details of any revenue account items shown in Forms 5 and 8 which have been apportioned between life business and general business, and the methods of apportionment used.

#### 7.7.5.4 *Other points to check*

None

#### 7.7.5.5 *Other considerations*

The following points should also be considered:

- Do the amounts of gains or losses from financial assets and investments look reasonable in relation to the assets held?

The following information is relevant to **capital risk**:

- Has the company made an overall loss before tax?

#### 7.7.6 Accounts – Balance Sheet

##### 7.7.6.1 *Purpose*

The IAS Balance Sheet is only different from Form 1 in the Returns in the frequency that it is required, and in the significant number of notes required to the accounts.

##### 7.7.6.2 *Cross references*

See Form 1.

##### 7.7.6.3 *Supplementary note*

Notes 3 to 17 are largely duplicating data found elsewhere in the returns. However the details of the other, non-insurance liabilities of the company in notes 18 to 23 are not duplicated, and may contain information of interest to the Commission.

18.	<i>Bank Loans</i> – This note lists the bank loans taken out by the company, and subdivides by those due to be repaid within a year, and those of longer term. Normally, insurance companies should <u>not</u> be resorting to this form of financing. Bank loans are not considered either Core Capital or Supplementary Capital, and represent an expensive form of poor quality capital. Any insurance company that has a significant amount of bank loans should be investigated.
19.	<i>Accounts Payable</i> – are subdivided into Agents, Brokers, Subsidiaries & Associates, Employees and Others. Any large increases from the Previous Period to the Current Period might be investigated
20.	<i>Due to other insurers</i> – are subdivided into Local insurance and reinsurance companies, Foreign Insurance companies and Foreign Reinsurance Companies. In theory the total due to other local insurers across all the Jordanian Industry should equal the total due from local insurers shown in note 5. In practice this is unlikely to work perfectly. Excessive amounts due to reinsurers compared to the annual reinsurance premiums may need investigating, as there may be a danger of relationship issues leading to claims not being honoured.
21.	<i>Loans</i> – are subdivided into those due within one year, and those due after one year. Loans may be made for entirely reasonable business purposes, for example to spread the cost of large capital purchases like computer / telecommunications equipment, property or vehicles. Conversely the existence of loans may suggest that the company has cash flow or liquidity problems. Any significant movements in these liabilities should be understood.
22.	<i>Other Provisions</i> – are sub-divided into the Provision for Staff Indemnity, Income Tax Provision, Research and Vocational Training Provision, University Fees Provision and Other Provisions. Details of the movement in the income tax provision are shown. Trends in these provisions should be examined. If any other provisions have a significant impact on the financial position of the company these should be investigated further. If the Provision for Staff Indemnity is handled in accordance with IAS19 the basis used should be described fully.
23.	<i>Other Liabilities</i> – are Accrued Expenses, Unearned Revenues, Board of Directors Remuneration and Others. Again trends should be investigated.

#### 7.7.6.4 Other points to check

See Form 1.

#### 7.7.6.5 Other considerations

See Form 1.

## 7.7.7 Accounts – Statement of Income

### 7.7.7.1 Purpose

The IAS Statement of Income is only different from Form 2 in the Returns in the frequency that it is required, and in the notes required to the accounts.

### 7.7.7.2 Cross references

See Form 2.

### 7.7.7.3 Supplementary notes

Notes 29 to 32 provide a breakdown of certain items, and may contain information of interest to the Commission.

29.	<i>Interest Revenue</i> – The interest yield on each category of asset should be monitored using the formulae shown in section 6.3.4.1 and 6.3.4.2
30.	<i>Gain (Loss) from Investments &amp; Financial Assets</i> – <a href="#">[GAD comment]</a> : Dividends received, net rent revenue and the Company share of profit of subsidiaries & associates are shown in this note, but should appear in Note 29. Dividends received should be split by the constituent type of asset, and not be shown separately. There is a line for transferring to underwriting accounts, but the underwriting accounts do not have a line for any gains/losses.  Overall yields on financial assets held for trading and property can be assessed from notes 29 and 30, and where these look anomalous of line may be questioned.
31.	<i>Other Revenues</i> – Any other sources of revenue should be clearly understood. As far as possible the Insurance Commission should seek to ensure that insurance companies are undertaking only Insurance Business (see section 14.1)
32.	<i>Administrative and General Expenses</i> – This note shows a detailed breakdown of the expenses of the company. Most of this detail will not be of interest to the Commission. The Insurance Commission should seek to understand whether the changes in Other Provision (described in note 22 to the Balance Sheet) pass through the Statement of Income or not. If any changes in provisions are not recognised in the Statement of Income, does this potentially increase the volatility of the company's results? There is also a danger that such volatility will produce results that are counter to the reasonable expectations of any with-profits / participating policyholders.

### 7.7.7.4 Other points to check

See Form 2.



#### *7.7.7.5 Other considerations*

See Form 2.

#### *7.7.8 Accounts – Statement of Changes in Shareholders Equity*

##### *7.7.8.1 Purpose*

The Statement of Changes in Shareholders Equity is produced according to IAS 1, paragraphs 96 to 101.

##### *7.7.8.2 Cross references*

The purpose of the account is to reconcile the Balance Sheet Shareholders Equity at the start and end of the year. Therefore it should be possible to fully cross-reference these accounts.

##### *7.7.8.3 Supplementary notes*

None.

##### *7.7.8.4 Other points to check*

None.

##### *7.7.8.5 Other considerations*

None.

#### *7.7.9 Accounts – Cash Flow Statement*

##### *7.7.9.1 Purpose*

The Cash Flow Statement is produced according to IAS 7.

##### *7.7.9.2 Cross references*

The Cash Flow statement is often of limited value to the regulator, and can be difficult to reconcile with other accounts and forms.

If there appear to be any significant anomalies, these may be worth investigating.

##### *7.7.9.3 Supplementary notes*

None.

##### *7.7.9.4 Other points to check*

None.

##### *7.7.9.5 Other considerations*

None.

## 7.8 Life Business – Profit and Loss Accounts

- Purpose
- *Forms included*

These include 3 Forms from the Returns and the equivalent 3 from the Accounts:

Form 3	Life Underwriting Revenue
Form 4	Life Cost of Claims
Form 5	Life Underwriting Profit and Loss Account
Accounts	Life Underwriting Revenue
Accounts	Life Cost of Claims
Accounts	Life Underwriting Profit and Loss Account

The only difference between the accounts and the Forms 3 to 5 is that the Accounts are produced under the Companies Act, and are therefore available more widely than the returns that are just submitted to the Insurance Commission.

No detailed comments are made on the Accounts in this section.

- *Required Frequency*

Forms 3, 4 and 5 are required quarterly

The Accounts are required annually

### 7.8.1 Form 3 – Life Underwriting Revenue

#### 7.8.1.1 *Purpose*

This form calculates the net earned premium for the current period and the previous period for each licence of life insurance.

It uses the Unexpired Premium Provision calculated on a 1/365<sup>th</sup> basis, so that the net earned premium income assumes that the risk is spread uniformly over the period of the insurance contract.

#### 7.8.1.2 *Cross references*

1.	For each licence the Net Earned Premium Income should equal the corresponding entry in Form 5.
2.	The Gross and Net Unexpired Premium Provision at the end of the period plus the Gross and Net UPP from Form 6 should equal the corresponding items in the Form 1 Balance Sheet.
3.	Cross references to Solvency Forms are discussed in the sections on these forms.

### 7.8.1.3 Supplementary notes

1.	Any licence where the amount of written premium netted off as a result of a policy being Not Taken Up or Cancelled from Inception exceeds 5% of the total written premium, the amount of premium netted off should be stated.
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### 7.8.1.4 Other points to check

Does the reinsurers' share of the UPP look reasonable compared with the reinsurers share of the written premiums?

What are the trends in the net earned premium income by insurance licence (and overall)? This is probably best analysed by using rolling 12 month averages of the net earned premium income. This has the advantage of eliminating the impact of seasonality. Any large movements either increases or decreases might be investigated.

### 7.8.1.5 Other considerations

Has there been a significant change in the ratio of net written premium to gross written premium for any accounting class (or overall)? Is this of regulatory concern?

## 7.8.2 Form 4 - Life Cost of Claims

### 7.8.2.1 Purpose

This form analyses the net cost of claims incurred for the current period and the previous period for each licence of life insurance.

### 7.8.2.2 Cross references

1.	For each licence the Cost of Claims Incurred should equal the corresponding entry in Form 5.
2.	The Gross and Net Outstanding Claim Provision at the end of the period, plus the Gross and Net OCP in Form 7, should equal the corresponding items in the Form 1 Balance Sheet.
3.	Cross references to Solvency Forms are discussed in the sections on these forms.

### 7.8.2.3 Supplementary notes

1.	Any non-proportional reinsurance claims should be identified.
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### 7.8.2.4 Other points to check

None

#### 7.8.2.5 Other considerations

The following points should also be considered:

- Have there been significant changes in the amounts of technical reserves since the previous year? If so, are these reasonable and do they generate any regulatory concern?
- Does the amount of subrogation look reasonable? The majority of life insurance contracts are not contracts of indemnity, so that it is unusual for an insurance company to be able to recoup its losses from a Third Party. Exceptions may arise for Medical Expenses insurance or for any Workers compensation cover that may be classified as life insurance, but in general the amount of subrogation in the life class should be zero or small.
- How do the Outstanding Claims Provisions compare as proportion of the Claims Paid, comparing across insurance licences, between different companies, and looking at trends over time?
- How do the IBNR provisions appear as a proportion of the total Outstanding Claims Provision?

### 7.8.3 Form 5 – Life Underwriting Profit and Loss Account

#### 7.8.3.1 Purpose

This form represents the profit and loss account for life business.

#### 7.8.3.2 Cross references

1.	For each licence the Net Earned Premium Income should equal the corresponding entry in Form 3.
2.	For each licence the Cost of Claims Incurred should equal the corresponding entry in Form 4.
3.	Cross references to Solvency Forms are discussed in the sections on these forms.

### 7.8.3.3 Supplementary notes

1.	Details of any other Technical Provisions or Catastrophic Risk Provisions held in respect of life business
2.	Reason for any difference between amounts shown in for the previous period and the corresponding amounts for the current period in the prior periods returns (other than differences as a result of currency movements)
3.	If the company maintains more than one life fund, or sub-funds, for which a separate surplus is determined, details of the principles and methods applied to apportion the investment income, the increase or decrease in the value of assets, expenses and taxation, between the different funds.
4.	If management services have been provided by another company for all or part of the year, the name of the party involved and the period for which the services were provided
5.	If there were any realised or unrealised capital gains attributable to the assets backing the life insurance technical provisions and other liabilities that are being used to support the interest rates using in determining the mathematical reserves, then these should be included in the Investment Income line, and set out in a note

### 7.8.3.4 Other points to check

None

### 7.8.3.5 Other considerations

The following points should also be considered:

- Have there been significant changes in any of the revenue account items for any of the accounting classes, compared with the previous period? If so, are they reasonable and do they generate any regulatory concern?

The following information is relevant to **capital risk**:

- High or increasing claims ratios or expense ratios.
- Large volume of business in a loss-making accounting class.

The following information is relevant to **strategy/environment risk**:

- Large increase or reduction in business in any accounting class (or overall).
- Limited product range or reliance on one main class of business.

The following information may be derived from this form:

- Claims ratio = net incurred claims / net earned premium income
- Expense ratio = net commission and expenses / net earned premium income

- Underwriting ratio =  $1 - \text{underwriting profit (loss)} / \text{net earned premiums income}$

Each of these ratios is produced for each accounting class and for life business as a whole.

However it should be noted that the different structures of life contract may make these ratios difficult to compare between companies, as difference proportions of the premium may be invested, rather than all going to risk premiums and expenses as in general insurance.

The following point relating to investments should also be considered:

- Is the yield on the fund reasonable in relation to the assets held?

The following information may be derived from this form:

- Yield on life business assets =  $2I / (F_0 + F_1 - I)$  where I = net investment income and capital gains allocated to the life business assets during the period, and  $F_0$  and  $F_1$  are the value of the fund at the beginning and end of the period respectively.

## 7.9 General Business – Profit and Loss Accounts

- Purpose
- *Forms included*

This category includes 3 basic Forms from the Returns and the equivalent 3 from the Accounts, and 3 motor insurance specific Forms from the Returns:

Form 6	Non-Life Underwriting Revenue
Form 7	Non-Life Cost of Claims
Form 8	Non-Life Underwriting Profit and Loss Account
Accounts	Non-Life Underwriting Revenue
Accounts	Non-Life Cost of Claims
Accounts	Non-Life Underwriting Profit and Loss Account
Form 14	Motor Underwriting Revenue
Form 15	Motor Cost of Claims
Form 16	Motor Underwriting Profit and Loss Account

The only difference between the accounts and the Forms 6 to 8 is that the Accounts are produced under the Company's Act, and are therefore available more widely than the returns that are just submitted to the Insurance Commission.

No detailed comments are made on the Accounts in this section.

- *Required Frequency*

Forms 6, 7 and 8 are required quarterly.

The Accounts are required annually.

Forms 14, 15 and 16 are also required quarterly.

### 7.9.1 Form 6 – Non-Life Underwriting Revenue

#### 7.9.1.1 Purpose

This form analyses the net earned premium for the current period and the previous period for each licence of general insurance.

It uses the Unexpired Premium Provision calculated on a 1/365<sup>th</sup> basis, so that the net earned premium income assumes that the risk is spread uniformly over the period of the insurance contract.

#### 7.9.1.2 Cross references

1.	For each licence the Net Earned Premium Income should equal the corresponding entry in Form 8.
2.	The Gross and Net Unexpired Premium Provision at the end of the period, plus the Gross and Net UPP from Form 3, should equal the corresponding items in the Form 1 Balance Sheet.
3.	Cross references to Solvency Forms are discussed in the sections on these forms.

#### 7.9.1.3 Supplementary notes

1.	Any licence, where the amount of written premium netted off as a result of a policy being Not Taken Up or Cancelled from Inception exceeds 5% of the total written premium, then the amount of premium netted off should be stated.
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#### 7.9.1.4 Other points to check

Does the reinsurers' share of the UPP look reasonable compared with the reinsurers share of the written premiums?

What are the trends in the net earned premium income by insurance licence (and overall)? This is probably best analysed by using rolling 12 month averages of the net earned premium income. This has the advantage of eliminating the impact of seasonality (many classes of insurance tend to renew at particular time of year). Any large movements either increases or decreases might be investigated.

#### 7.9.1.5 Other considerations

Has there been a significant change in the ratio of net written premium to gross written premium for any accounting class (or overall)? Is this of regulatory concern?

#### 7.9.2 Form 7 – Non-Life Cost of Claims

##### 7.9.2.1 Purpose

This form analyses the net cost of claims incurred for the current period and the previous period for each licence of general insurance.

##### 7.9.2.2 Cross references

1.	For each licence the Cost of Claims Incurred should equal the corresponding entry in Form 8.
2.	The Gross and Net Outstanding Claim Provision at the end of the period, plus the Gross and Net OCP in Form 4, should equal the corresponding items in the Form 1 Balance Sheet.
3.	Cross references to Solvency Forms are discussed in the sections on these forms.

##### 7.9.2.3 Supplementary notes

1.	Any non-proportional reinsurance claims should be identified.
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##### 7.9.2.4 Other points to check

None

##### 7.9.2.5 Other considerations

Does the amount of salvage and subrogation look reasonable?

How do the Outstanding Claims Provisions compare as proportion of the Claims Paid, comparing across insurance licences, between different companies, and looking at trends over time?

How do the IBNR provisions appear as a proportion of the total Outstanding Claims Provision?

#### 7.9.3 Form 8 – Non-Life Profit and Loss Account

##### 7.9.3.1 Purpose

This form represents the profit and loss account for general business.



### 7.9.3.2 Cross references

1.	For each licence the Net Earned Premium Income should equal the corresponding entry in Form 6.
2.	For each licence the Cost of Claims Incurred should equal the corresponding entry in Form 7.
3.	Cross references to Solvency Forms are discussed in the sections on these forms.

### 7.9.3.3 Supplementary notes

1.	Details of any other Technical Provisions held.
2.	Reason for any difference between amounts shown in for the previous period and the corresponding amounts for the current period in the prior periods returns (other than differences as a result of currency movements)
3.	If management services have been provided by another company for all or part of the year, the name of the party involved and the period for which the services were provided

### 7.9.3.4 Other points to check

None

### 7.9.3.5 Other considerations

The following points should also be considered:

- Have there been significant changes in any of the revenue account items for any of the accounting classes, compared with the previous period? If so, are they reasonable and do they generate any regulatory concern?

The following information is relevant to **capital risk**:

- High or increasing claims ratios or expense ratios.
- Large volume of business in a loss-making accounting class.

The following information is relevant to **strategy/environment risk**:

- Large increase or reduction in business in any accounting class (or overall).
- Limited product range or reliance on one main class of business.

The following information may be derived from this form:

- Claims ratio = net incurred claims / net earned premium income

- Expense ratio = net commission and expenses / net earned premium income
- Underwriting ratio = 1 – underwriting profit (loss) / net earned premiums income

Each of these ratios is produced for each accounting class and for general business as a whole.

#### 7.9.4 Form 14 – Motor Underwriting Revenue

##### 7.9.4.1 *Purpose*

This form analyses the net earned premium for the current period and the previous period for different sub-divisions of motor insurance.

It uses the Unexpired Premium Provision calculated on a 1/365<sup>th</sup> basis, so that the net earned premium income assumes that the risk is spread uniformly over the period of the insurance contract.

##### 7.9.4.2 *Cross references*

1.	For each licence the Net Earned Premium Income should equal the corresponding entry in Form 16.
2.	Totals of each item should equal the items in the Motor Class column in Form 6.

##### 7.9.4.3 *Supplementary notes*

1.	Any licence where the amount of written premium netted off as a result of a policy being Not Taken Up or Cancelled from Inception exceeds 5% of the total written premium, the amount of premium netted off should be stated.
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##### 7.9.4.4 *Other points to check*

Does the reinsurers share of the UPP look reasonable compared with the reinsurers share of the written premiums?

What are the trends in the net earned premium income by each sub-division? This is probably best analysed by using rolling 12 month averages of the net earned premium income. This has the advantage of eliminating the impact of seasonality (many classes of insurance tend to renew at particular time of year). Any large movements either increases or decreases might be investigated.

#### 7.9.4.5 Other considerations

Has there been a significant change in the ratio of net written premium to gross written premium for sub-division? Is this of regulatory concern?

#### 7.9.5 Form 15 – Motor Cost of Claims

##### 7.9.5.1 Purpose

This form analyses the net cost of claims incurred for the current period and the previous period for various sub-divisions of the motor class.

##### 7.9.5.2 Cross references

1.	For each licence the Cost of Claims Incurred should equal the corresponding entry in Form 14.
2.	Totals of each item should equal the items in the Motor Class column in Form 7.

##### 7.9.5.3 Supplementary notes

1.	Any non-proportional reinsurance claims should be identified.
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##### 7.9.5.4 Other points to check

None

##### 7.9.5.5 Other considerations

Does the amount of salvage and subrogation look reasonable?

How do the Outstanding Claims Provisions compare as proportion of the Claims Paid, comparing across insurance licences, between different companies, and looking at trends over time?

How do the IBNR provisions appear as a proportion of the total Outstanding Claims Provision?

In particular differences between companies in the compulsory TPL business may need to be investigated carefully. Where companies are sharing business it might be expected that accounting entries and provisions would be similar.

#### 7.9.6 Form 16 – Motor Underwriting Profit and Loss Account

##### 7.9.6.1 Purpose

This form represents the profit and loss account for motor business sub-divided into various categories (as Forms 14 and 15)

#### 7.9.6.2 Cross references

1.	For each licence the Net Earned Premium Income should equal the corresponding entry in Form 14.
2.	For each licence the Cost of Claims Incurred should equal the corresponding entry in Form 15.
3.	Totals of each item should equal the items in the Motor Class column in Form 8.

#### 7.9.6.3 Supplementary notes

1.	Details of any other Technical Provisions held.
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#### 7.9.6.4 Other points to check

Do the amounts shown for the previous period agree with those shown in for the current period for in the prior quarters' returns? If not, is there a supplementary note giving a valid explanation, or could the differences reasonably result from currency movements?

If the company holds an catastrophic risks provision or any "other technical provisions", has the movement in these provisions been included in this form?

#### 7.9.6.5 Other considerations

The following points should also be considered:

- Have there been significant changes in any of the revenue account items for any of the accounting classes, compared with the previous period? If so, are they reasonable and do they generate any regulatory concern?

The following information is relevant to **capital risk**:

- High or increasing claims ratios or expense ratios.
- Large volume of business in a loss-making accounting class.

The following information is relevant to **strategy/environment risk**:

- Large increase or reduction in business in any accounting class (or overall).
- Limited product range or reliance on one main class of business.

The following information may be derived from this form:

- Claims ratio = net incurred claims / net earned premium income
- Expense ratio = net commission and expenses / net earned premium income

- Underwriting ratio =  $1 - \text{underwriting profit (loss)} / \text{net earned premiums income}$   
Each of these ratios is produced for each accounting class and for general business as a whole.

## 7.10 Debt Analysis

- Purpose

These forms analyse the debts due to the company.

They allow the Commission to make some assessment of the adequacy of the bad debt provisions.

Inter-company comparisons may show up interesting differences, and the companies with the highest debt ratios could be investigated further.

Trends in debt ratios can also be tracked, and any significant deterioration can also be investigated.

Experience has shown that problems with debts in insurance company accounts can lead to solvency problems. The Insurance Commission in Jordan has better information on insurance company debts than most other Regulators, and may therefore be able to detect issues arising more quickly.

The debt analysis forms are required on a Global and on a Global Consolidated basis as well as a Branch basis. The cross-references below refer only to those forms completed on a Branch basis.

- *Forms included*

These include 4 Forms:

Form 9	Accounts Receivable
Form 10	Due from Other Insurers
Form 11	Receivable Notes & Post-Dated Cheques
Form 12	Over-due loans Instalments

- *Required Frequency*

These forms are required half-yearly.

### 7.10.1 Form 9 – Accounts Receivable

#### 7.10.1.1 *Purpose*

This form analyses the accounts receivable from Policyholders, Agents, Brokers, Subsidiaries & Associates Companies, Employees and Others.

### 7.10.1.2 *Cross references*

1.	The total accounts receivable should equal the total shown on the Form 1 Balance Sheet.
2.	The account due for each category should equal the total shown in note 4 to the Accounts (at the year end only).

### 7.10.1.3 *Supplementary notes*

None.

### 7.10.1.4 *Other points to check*

Any accounts that are overdue by more than 360 days should in most cases be fully provided against. Any such debt should be investigated.

The nature of any debts from Employees should also be investigated, and the extent to which the company is protected by any leaving service benefits.

Accounts from Subsidiaries and Associates should be inadmissible in the solvency margin calculation.

### 7.10.1.5 *Other considerations*

The debt ratios discussed in section 6.2.7.1 (Agents Balances / Total Assets) and 6.2.7.2 (Agents Balances / Gross Written Premiums) can be extended to the other accounts receivable.

The trends in these ratios over time, and the inter-company comparisons can be monitored.

It is also possible to construct an index of how over-due debts are:

$$\begin{aligned} \text{Overdue Factor} = & ((\text{Receivable overdue } < 90 \text{ days}) * 45 \\ & + (\text{Receivables overdue } > 90, < 180 \text{ days}) * 135 \\ & + (\text{Receivables overdue } > 180, < 360) * 270 \\ & + (\text{Receivables overdue } > 360) * 430) \\ & / \text{Total Receivables} \end{aligned}$$

The Receivables included in the factor should be net of any bad debt provisions.

Whilst any index on limited data is inevitably approximate, it can be a simple way to make comparisons between companies, and to track changes over time.

## 7.10.2 Form 10 – Due from Other Insurers

### 7.10.2.1 *Purpose*

This Form analyses the amounts due from other Insurers, split by amounts due from local insurers, and amount due from foreign reinsurers.

#### 7.10.2.2 *Cross references*

1.	The total due from other insurers should equal the total shown on the Form 1 Balance Sheet.
2.	The amount due for each category of insurer should equal the total shown in note 5 to the Accounts (at the year end only).

#### 7.10.2.3 *Supplementary notes*

Any bad debt provisions should be identified, together with the reason for the provision, when the provision was last changed and how it was changed.

Any debts that are more than 360 days overdue, and have not been fully written off should be described in detail.

#### 7.10.2.4 *Other points to check*

Any debts from local insurance companies may result from coinsurance of compulsory motor cover.

Inter-company comparisons may identify problems with particular company's ??

#### 7.10.2.5 *Other considerations*

Bad debts relating to reinsurance claims may be a particular concern where such claims are large.

There is also a danger that a reinsurance claim being repudiated may imply some weakness in the reinsurance arrangement, and may lead to additional exposure for the company.

The ratios and the index described in section 7.10.2.5 may also be applied here.

### 7.10.3 Form 11 – Receivable Notes & Post-Dated Cheques

#### 7.10.3.1 *Purpose*

This form analyses receivable notes and post-dated cheques.

The way these are handled in Jordan is slightly different from international practice, where both items would be described as premiums outstanding or agents/broker balances as appropriate (or if the debt is due from another party, the debtor would be identified).

**[GAD comment]:** We are not sure over what period market practice in Jordan allows receivable notes or Post-Dated Cheque's to be used. The financial impacts are quite different where premiums are being paid in 3 monthly instalments in the first three months of the year, compared to 12 monthly instalments over the entire year. In the former case default of the premium instalments may profit the company, in the second it may lead to losses.

### 7.10.3.2 *Cross references*

1.	The total of receivable notes and Post-Dated Cheques should equal the total shown on the Form 1 Balance Sheet.
2.	The total of receivable notes, and of post-dated cheques should equal the total shown in note 6 to the Accounts (at the year end only).
3.	The figures shown at the end of the Previous Period should be equal to those shown at the Current Period, in the returns submitted at the prior half-year, subject to any differences caused by exchange rate movements.

### 7.10.3.3 *Supplementary notes*

Any receivable notes or post-dated cheques payable on individual life policies where the mathematical reserves are established using a prospective valuation method should be identified.

**[IGAD comment]:** Receivable notes and post-dated cheques in respect of any compulsory motor insurance policies where the policyholder is in possession of documentation that proves cover is in force for the full year should be disclosed. We're not aware of Jordanian market practice in this area, but from experience of other territories there may be a risk that for any compulsory covers where it is a criminal offence not to have the insurance, there may be a danger that initial instalments will be paid in order to have proof that the insurance cover is in place.

### 7.10.3.4 *Other points to check*

If there has been any movement in the data shown in the form at the Previous Period, compared to the Current Period in the form submitted at the prior half-year, then do any adjustments for exchange rate movements look reasonable.

### 7.10.3.5 *Other considerations*

The trend in receivable notes and post-dated cheques as a percentage of annualised written premiums should be monitored.

Those companies that have the highest ratio might be further investigated. For instance it may be useful to determine what the default rates are on these instalment methods are.

It may be that certain insurance classes may be over-represented. If the level of receivable notes and/or post-dated cheques looks high it may be useful to obtain a breakdown by class.

## 7.10.4 Form 12 – Over-due loans Instalments

### 7.10.4.1 *Purpose*

This form analyses the policy loans, other loans and loans for subsidiaries, associates and related parties.



#### 7.10.4.2 *Cross references*

1.	The total of over-due loans should equal the total of over-due loans shown in note 11 to the Accounts (at the year end only).
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#### 7.10.4.3 *Supplementary notes*

None

#### 7.10.4.4 *Other points to check*

Loans to subsidiaries, associates and related parties are inadmissible assets for solvency purposes.

#### 7.10.4.5 *Other considerations*

It is not usual for insurance companies to be successful in recouping any loans in excess of the surrender value on policies.

If any loans in excess of surrender values are treated as assets (i.e. not 100% provided against) then the Insurance Commission might ask what success rate the company has had in recovering these debts.

The ratios and the index described in section 7.10.2.5 may also be applied here.

### 7.11 **Invested Assets**

- Purpose
- *Forms included*

This category includes:

Form 13	Property Investments
Form 17A	Financial Assets for Trading - Shares
Form 17B	Financial Assets for Trading - Bonds
Form 18A	Available for Sale Financial Assets – Listed Shares
Form 18B	Available for Sale Financial Assets – Non-listed Shares
Form 18C	Available for Sale Financial Assets – Bonds
Form 19	Held to Maturity Investments
Form 20	Investments in Subsidiaries & Associates

#### Required Frequency

These forms are required half-yearly.

### 7.11.1 Form 13 – Property Investments

#### 7.11.1.1 *Purpose*

This form provides a break down of all directly held property investments valued according to IAS rules. The form sub-divides the data between land and property, and inside and outside Jordan.

It should be completed separately for property held for use of the company, its employees, subsidiaries and associates which are considered Fixed Assets in the IAS Balance Sheet, and for other properties which are considered Property Investments

#### 7.11.1.2 *Cross references*

1.	The total of Property Investments in Form 13 should equal the Property investments shown in Form 1.
2.	The total of Property held for Own Use in Form 13 should equal the total of land and buildings in note 17 to the Accounts (within the Fixed Assets).
3.	The total of Property Investments in Form 13 should equal the book value of the Investments in Real Estate shown in Annex (3) Capital Required for Asset Risks.
4.	The total of Property held for Own Use in Form 13 should equal the total of the book value of Real Estate under Fixed Assets in Annex (3) Capital Required for Asset Risks.
5.	The total Property (both Investments and for Own Use) inside Jordan should equal the IAS value of the corresponding item in Form 31A.
6.	The total Land (both Investments and for Own Use) inside Jordan should equal the IAS value of the corresponding item in Form 31A.
7.	The total Property (both Investments and for Own Use) outside Jordan should equal the IAS value of the corresponding item in Form 31B.
8.	The total Land (both Investments and for Own Use) outside Jordan should equal the IAS value of the corresponding item in Form 31B.

#### 7.11.1.3 *Supplementary notes*

None.

#### 7.11.1.4 *Other points to check*

None.

#### 7.11.1.5 *Other considerations*

Property Investment can often be a risky asset class for an insurance company, and yet, conversely, may often offer an excellent investment opportunity, and a method of diversifying the investment portfolio.

Special considerations apply to an insurance company owning its own offices, which can have clear advantages.

Property is regarded as an inflation-linked asset as, very broadly, there is an expectation that property rents will increase over time in line with economic growth. It is therefore a suitable asset to back inflationary liabilities such as long term with-profits plans, and expenses reserves (life insurance).

However it may not be a suitable asset to back short term liabilities because of the need for liquidity.

#### 7.11.2 Form 17A – Financial Assets for Trading - Shares

##### 7.11.2.1 *Purpose*

This form provides a list of the equity share assets that are classed as Financial Assets for Trading according to the IAS method of classifying assets.

##### 7.11.2.2 *Cross references*

1.	The total of the Financial Assets for Trading in Form 17A and 17B should equal the Financial Assets for Trading in Form 1 (subject to all money market instruments and Certificates of Deposit being classified as deposits at banks)
2.	The listed and unlisted shares, inside and outside Jordan should be the same as the IAS values of the corresponding entries in Forms 31A and 31B (subject to there being no collective investments or units holdings that are best classified as equity investments).
3.	The total fair value of shares should equal the book value of the Trading securities in Annex (3) Capital Required for Asset Risks.

##### 7.11.2.3 *Supplementary notes*

None.

##### 7.11.2.4 *Other points to check*

Any collective investments or unit holdings that contain any equity content and are classed as Financial Assets for Trading should be listed here.

If the Insurance Commission decides to approve the holding of structured investment products that have the effects of derivatives, and these are classed as Financial Assets for Sale then they should be listed on this form.

##### 7.11.2.5 *Other considerations*

It may be quite difficult to determine the fair or market value of an unlisted or infrequently traded equity investment.

One reasonable approach is to take the dividend payment over the last year and compare with the dividend payable on either a market index for a sector appropriate to the

company being valued, or a similar quoted or frequently traded company if one can be found.

### 7.11.3 Form 17B – Financial Assets for Trading - Bonds

#### 7.11.3.1 *Purpose*

This form provides a list of the bond assets that are classed as Financial Assets for Trading according to the IAS method of classifying assets.

#### 7.11.3.2 *Cross references*

1.	The total of the Financial Assets for Trading in Form 17A and 17B should equal the Financial Assets for Trading in Form 1 (subject to all money market instruments and Certificates of Deposit being classified as deposits at banks).
2.	The government and non-government, listed and unlisted bonds, inside and outside Jordan should be the same as the IAS values of the corresponding entries in Forms 31A and 31B (subject to there being no collective investments or units holdings that are best classified as bond investments).
3.	The total fair value of bonds should equal the total book value of the Trading securities in Annex (3) Capital Required for Asset Risks.
4.	Using the information Form 17B it should be possible to fully reconcile the separate bond entries in Annex (3) Capital Required for Asset Risks.

#### 7.11.3.3 *Supplementary notes*

None.

#### 7.11.3.4 *Other points to check*

Any collective investments or unit holdings that contain bonds and cash content only and are classed as Financial Assets for Trading should be listed here.

#### 7.11.3.5 *Other considerations*

It may be quite difficult to determine the fair or market value of an unlisted or infrequently traded bond investment. One approach is to try to determine a reasonable interest rate to value the future cash flows. This interest rate may be found by considering the interest rates payable on traded bonds of a similar rating and duration. If the bond is unrated it may still be possible to estimate an interest rate to discount the cash flows at based on other similar bonds available in the market. Alternatively, it may be possible to add a “reasonable” margin onto the risk-free yield.

#### 7.11.4 Form 18A – Available for Sale Financial Assets – Listed Shares

##### 7.11.4.1 *Purpose*

This form provides details of the listed shares that are classed as Available for Sale Financial Assets according to the IAS method of classifying assets.

##### 7.11.4.2 *Cross references*

1.	The total of the Available for Sale Financial Assets in Forms 18A, 18B and 18C should equal the Available for Sale Financial Assets Form 1 (subject to all money market instruments and Certificates of Deposit being classified as deposits at banks).
2.	The listed shares, inside and outside Jordan should be the same as the IAS values of the corresponding entries in Forms 31A and 31B.
3.	The total of listed and unlisted shares in Forms 18A and 18B should equal the total book value of the Shares in the Available for Sale Securities in Annex (3) Capital Required for Asset Risks.

##### 7.11.4.3 *Supplementary notes*

None.

##### 7.11.4.4 *Other points to check*

Any listed collective investments or unit holdings that contain any equity content and are classed as Available for Sale Financial Assets should be listed here.

##### 7.11.4.5 *Other considerations*

It may be quite difficult to determine the fair or market value of an infrequently traded equity investment. One reasonable approach is to take the dividend payment over the last year and compare with the dividend payable on either a market index for a sector appropriate to the company being valued, or a similar quoted or frequently traded company if one can be found.

### 7.11.5 Form 18B – Available for Sale Financial Assets – Non-Listed shares

#### 7.11.5.1 *Purpose*

1.	The total of the Available for Sale Financial Assets in Forms 18A, 18B and 18C should equal the Available for Sale Financial Assets Form 1 (subject to all money market instruments and Certificates of Deposit being classified as deposits at banks)
2.	The unlisted shares, inside and outside Jordan should be the same as the IAS values of the corresponding entries in Forms 31A and 31B.
3.	The total of listed and unlisted shares in Forms 18A and 18B should equal the total book value of the Shares in the Available for Sale Securities in Annex (3) Capital Required for Asset Risks.

#### 7.11.5.2 *Cross references*

See 7.11.5.2

#### 7.11.5.3 *Supplementary notes*

None

#### 7.11.5.4 *Other points to check*

Any unlisted collective investments or unit holdings that contain any equity content and are classed as Available for Sale Financial Assets should be listed here.

If the Insurance Commission decides to approve the holding of structured investment products that have the effects of derivatives, and these are classed as Available for Sale Financial Assets then they should be listed on this form.

#### 7.11.5.5 *Other considerations*

It may be quite difficult to determine the fair or market value of an unlisted equity investment. One reasonable approach is to take the dividend payment over the last year and compare with the dividend payable on either a market index for a sector appropriate to the company being valued, or a similar quoted or frequently traded company if one can be found.

### 7.11.6 Form 18C – Available for Sale Financial Assets - Bonds

#### 7.11.6.1 *Purpose*

This form provides a list of the bond assets that are classed as Available for Sale Financial Assets according to the IAS method of classifying assets.

#### 7.11.6.2 *Cross references*

1.	The total of the Available for Sale Financial Assets in Form 18A, 18B and 18C should equal the Available for Sale Financial Assets in Form 1 (subject to all money market instruments and Certificates of Deposit being classified as deposits at banks)
2.	The government and non-government, listed and unlisted bonds, inside and outside Jordan should be the same as the IAS values of the corresponding entries in Forms 31A and 31B (subject to there being no collective investments or units holdings that are best classified as bond investments).
3.	The total fair value of bonds should equal the total book value of the Available for Sale Securities in Annex (3) Capital Required for Asset Risks.
4.	Using the information Form 18C it should be possible to fully reconcile the separate bond entries in Annex (3) Capital Required for Asset Risks.

#### 7.11.6.3 *Supplementary notes*

None.

#### 7.11.6.4 *Other points to check*

Any collective investments or unit holdings that contain bonds and cash content only and are classed as Available for Sale Financial Assets should be listed here.

#### 7.11.6.5 *Other considerations*

It may be quite difficult to determine the fair or market value of an unlisted or infrequently traded bond investment. One approach is to try to determine a reasonable interest rate to value the future cash flows. This interest rate may be found by considering the interest rates payable on traded bonds of a similar rating and duration.

If the bond is unrated it may still be possible to estimate an interest rate to discount the cash flows at based on other similar bonds available in the market. Alternatively, it may be possible to add a “reasonable” margin onto the risk-free yield.

### 7.11.7 Form 19 – Held to Maturity Investments

#### 7.11.7.1 *Purpose*

This form provides a list of the bond assets that are classed as Held to Maturity Bond Assets according to the IAS method of classifying assets.

#### 7.11.7.2 *Cross references*

1.	The total of the Held to Maturity Bond Assets in Form 19 should equal the Held to Maturity Bond Assets in Form 1 (subject to all money market instruments and Certificates of Deposit being classified as deposits at banks)
2.	The government and non-government, listed and unlisted bonds, inside and outside Jordan should be the same as the IAS values of the corresponding entries in Forms 31A and 31B (subject to there being no collective investments or units holdings that are best classified as bond investments).
3.	The total carrying value of bonds should equal the total book value of the Held to Maturity Bonds in Annex (3) Capital Required for Asset Risks.
4.	Using the information Form 19 it should be possible to fully reconcile the separate bond entries in Annex (3) Capital Required for Asset Risks.

#### 7.11.7.3 *Supplementary notes*

None.

#### 7.11.7.4 *Other points to check*

Any collective investments or unit holdings that contain bonds and cash content only and are classed as Held to Maturity Bonds should be listed here (though it seems unlikely that any would be so classed).

#### 7.11.7.5 *Other considerations*

It is possible to attempt to estimate whether the amortisation method is being correctly applied. For short bonds (of up to 5 years) it is probably acceptable to amortise using a straight line depreciation method. Longer bonds should be amortised using the annuity amortisation method. However, it is not really clear that the Insurance Commission should be checking values produced for IAS purposes which have no bearing on the Solvency of the company which remains the main supervisory priority.

### 7.11.8 Form 20 – Investments in Subsidiaries and Associates

#### 7.11.8.1 *Purpose*

This form provides a list of the Investments in Subsidiaries and Associates.



#### 7.11.8.2 *Cross references*

1.	The total of the Investments in Subsidiaries and Associates in Form 20 should equal the Investments in Subsidiaries and Associates in Form 1.
2.	Using the information Form 20 it should be possible to fully reconcile the separate entries in the Book Values of Annex (3) Capital Required for Asset Risks.
3.	The total of the Investments in Subsidiaries and Associates in Form 20 should equal the corresponding entry in the book value Annex (3) Capital Required for Asset Risks.

#### 7.11.8.3 *Supplementary notes*

None.

#### 7.11.8.4 *Other points to check*

None.

#### 7.11.8.5 *Other considerations*

All investments in subsidiaries and associates are inadmissible for solvency purposes. From the solvency analysis perspective this form can, therefore, be largely disregarded.

**Comment [d33]:** Investments in financial subs and associates inadmissible; for non-financial, there is a 100% factor applied.

### 7.12 **Claims Analysis**

- Purpose

These forms provide additional analysis of the life and general claims. Form 21 and 22 should be completed separately for both life and general business. Form 26 should be completed in respect of Jordanian motor business only.

- *Forms included*

This category includes 3 Forms:

Form 21	Claims Settlement Analysis
Form 22	Claims Details Analysis
Form 26	Motor Claims Details

- *Required Frequency*

Form 21 is required annually.

Forms 22 and 26 are required half-yearly.

#### 7.12.1 Form 21 - Claims Settlement Analysis

#### 7.12.1.1 Purpose

This form shows how the amounts of claims incurred for each underwriting year, and each year of account, attributable to the current financial year, have been determined.

A detailed description of this form is included within the Guidance, and will not be repeated here.

#### 7.12.1.2 Cross references

1.	The total Reported Claims Provision and IBNR Provisions for each class shown should be equal to the corresponding items in Form 4 for Life Insurance and Form 7 for General Insurance.
2.	The total number of IBNR and Reported Claims at the start of the period, for each class, should equal the total number of outstanding claims at the start of the year in Form 22 (note Form 22 works on each period, rather than year to date, so that it is the Form 22 at 30/6 that should correspond to the Form 21 at 31/12), for items at the beginning of the year).
3.	For each class the total number of claims outstanding at the end of the year should equal the number of outstanding claims on Form 22.
4.	For each class the total amount of the Outstanding Claims Provision at the end of the year should equal the amount of the OCP in Form 22.

#### 7.12.1.3 Supplementary notes

None

#### 7.12.1.4 Other points to check

Has a separate form been submitted for each underwriting year and accounting class?

#### 7.12.1.5 Other considerations

Comparing the Form 21 submitted at the prior year end will show the extent to which the outstanding claims reserve held at the previous financial year end was sufficient to provide for the amounts paid in the current financial year and the outstanding claims reserve determined at the end of the current financial year.

Any shortfall implies under-reserving at the previous year end. A significant shortfall would be of concern.

Do the claims outstanding shown as incurred but not reported appear reasonable, in relation to the total claims outstanding and the age of the accident year?

The following information is relevant to **capital risk**:

- Are the claims ratios high, or increasing by accident year? Are the claims ratios for a given accident year higher than in the previous year's returns?

### 7.12.2 Form 22 - Claims Details Analysis

#### 7.12.2.1 *Purpose*

This form compares the movement in outstanding claims provision from the prior period end to this period end.

A detailed description of this form is included within the Guidance, and will not be repeated here.

#### 7.12.2.2 *Cross references*

1.	The total Reported Claims Provision and IBNR Provisions for each class shown should be equal to the corresponding items in Form 4 for Life Insurance and Form 7 for General Insurance.
2.	Cross references to Form 21 are included in section 7.12.2

- *Supplementary notes*

None

#### 7.12.2.3 *Other points to check*

Do the numbers of Outstanding Claims at the start of the period agree with the corresponding amounts shown as the number of Outstanding Claims Provision at the end of the financial period in the previous period's returns? If not, is there a supplementary note giving a valid explanation?

Do the amounts shown as the Outstanding Claims Provision at the start of the period agree with the corresponding amounts shown as the Revised Outstanding Claims Provision at the end of the financial period in the previous period's returns? If not, is there a supplementary note giving a valid explanation, or could the differences reasonably result from currency movements?

#### 7.12.2.4 *Other considerations*

None.

### 7.12.3 Form 26 – Motor Claims Details

- *Purpose*

This form allocates the motor claims over the period.

A detailed description of this form is included within the Guidance, and will not be repeated here.

### 7.12.3.1 *Cross references*

1.	The total premiums should equal the direct insurance premium and the facultative reinsurance premium accepted in Form 14.
2.	The total number of accidents at the end of the period should equal the total number of outstanding claims for the Motor class in Form 22
3	The total Outstanding Claims Provision at the end of the period should equal the total OCP for the Motor class in Form 22

### 7.12.3.2 *Supplementary notes*

1.	How the number of vehicles in line 1 was determined?
2.	How the IBNR was determined in the second quarter returns when no actuarial sign off is required.
3	Any inconsistency between the total invalid claims in line 11, and the motor claims settled at no cost during the period in Form 22.

### 7.12.3.3 *Other points to check*

None

### 7.12.3.4 *Other considerations*

Trends in the numbers and amount of claims by each type of claim should be monitored, and any significant adverse movements should be investigated.

Inter-company comparisons are important, particularly of the compulsory TPL business. The adequacy of the tariff rates for TPL motor should be monitored across the insurance industry.

- *Required Frequency*

### 7.12.3.5

1.	
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### 7.12.3.6 *Other considerations*

The following information is relevant to **strategy risk**:

- High or low volume of new business (relative to business in force)
- Large increase or reduction in new business compared with previous year (see new business index, produced by computer system)

**Comment [d34]:** Should this information stay in, despite the fact that forms not in force? It seems as though it could be calculated from other reports.

The following information may be derived from this form:

- New business index = new regular premiums + 10% \* single premiums

*Other considerations*

The following information is relevant to **strategy risk**:

- Poor persistency experience (see exit rate in section 6)

**7.13 Miscellaneous**

- Purpose

These useful forms are separated out into a miscellaneous category as they don't naturally fit with any of the other forms.

- *Forms included*

There are two Forms included in this category:

Form 29	Distributing Channels
Form 30	Concentration of Policies

- *Required Frequency*

Form 29 is required quarterly and Form 30 is required half-yearly.

- Form 29 Distributing Channels

*7.13.1.1 Purpose*

This form identifies the number of policies, the written premiums and the commission or salary cost of obtaining the business.

It is produced separately for each insurance licence.

*7.13.1.2 Cross references*

None.

*7.13.1.3 Supplementary notes*

1.	The costs of obtaining the business may be either commission or salary related. A note should identify which is applicable for each method of distribution
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*7.13.1.4 Other points to check*

None.

7.13.1.5 *Other considerations*

Trends in the ratio of the cost of obtaining business to the written premiums for each category of distribution should be monitored.

Inter-company comparisons may also be interesting.

Comparisons between companies of the cost of obtaining business ratio for the Motor business written via the Unified Bureau may be particularly interesting.

- Concentration of Policies

7.13.1.6 *Purpose*

This form seeks to identify concentrations of risk exposure to a single risk and concentrations of premiums from a single policy within a particular insurance licence

7.13.1.7 *Cross references*

None

7.13.1.8 *Supplementary notes*

1.	Any policies shown that relate to a group undertaking should be identified.
2.	Any known significant risk accumulations across more than one policy should be identified

7.13.1.9 *Other points to check*

None.

7.13.1.10 *Other considerations*

This form may be useful in two ways:

- Looking at risk accumulations, reinsurance strategy, catastrophe reinsurance programs, and catastrophic risk provisions.
- Identifying dependence on particular sources of business, in particular from group undertakings. This is not necessarily a weakness as it may make perfect sense for a large group to establish its own insurance company with the primary intention of insuring its own risks (operating as a captive insurer). Such risk transfers should be priced on a commercial basis, to avoid exposing the insurance company if premiums are too light, or conversely to avoid charges of tax avoidance if premiums are excessive

-

#### 7.13.1.11 *Other considerations*

In addition, the following points should normally be considered:

- Have there been any significant increases or reductions in the amount of technical provisions for any category of business, and are these reasonable with regard to changes in the volume of business in force and any known changes in valuation assumptions?

The following information is relevant to **capital risk**:

Is there a significant volume of annuity business?

The following information is relevant to **asset risk**: Is the company heavily dependent on reinsurance?

### 7.14 **Reinsurance**

- Purpose
- *Forms included*

Form 23 A/B Summary of Treaty Reinsurance Business Ceded

Form 24 Summary of Facultative Reinsurance Business

Form 25 Summary of Reinsurance—Treaty and Facultative

- *Required Frequency*

#### 7.14.1 Proportional Treaty Reinsurance Ceded

##### 7.14.1.1 Purpose

Unless the sum insured on any policy sold by the insurance company is restricted to a sufficiently low sum insured that it is possible for the Company to retain all the risk for its own account, there should be some form of proportional reinsurance in place on all classes of business written by the company.

These forms are there to demonstrate that this reinsurance treaty protection is in place where appropriate, which would normally be for most of an insurance company's business (where "most" is by numbers of policies issued, as facultative reinsurance is often used for larger risks).

##### 7.14.1.2 *Cross references*

None.

**Comment [d35]:** This text originally referred to required Appendices of Actuary Reports (not currently required). However, it seems equally appropriate with respect to forms detailing reinsurance in place.

#### 7.14.1.3 *Supplementary notes*

1.	A description of all doubtful recoveries/ bad debts
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#### 7.14.1.4 *Other points to check*

Are the treaties described consistent with the reinsurance information provided to the Commission at the start of the year.

Are the treaties consistent with the company's documented reinsurance strategy?

How different are the reinsurance treaties from those set up for the previous year? Are there any suggestions of significant relationship problems with one or more reinsurers?

#### 7.14.1.5 *Other consideration*

Good use of the international reinsurance market is important for all insurance companies around, and is especially important for small companies in rapidly developing markets.

As such it would be useful for the Insurance Commission to monitor the way reinsurance is used and the reinsurance results for proportional treaty reinsurance.

### 7.14.2 Facultative Reinsurance Ceded

#### 7.14.2.1 *Purpose*

Facultative reinsurance may be used for:

- larger risks that fall outside the capacity or terms and conditions of any treaty.
- unusual risks, that fall outside the terms and conditions of any treaty.
- There is competition to write a risk, and the treaty reinsurance terms would not allow the business to be secured.

All of these circumstances can lead to regulatory concerns.

#### 7.14.2.2 *Cross references*

None

#### 7.14.2.3 *Supplementary notes*

1.	A description of all doubtful recoveries/ bad debts
----	---

#### 7.14.2.4 *Other points to check*

Are the reinsurance arrangements consistent with the reinsurance information provided to the Commission at the start of the year.

Are the reinsurance arrangements consistent with the company's documented reinsurance strategy?

#### 7.14.2.5 *Other consideration*

**Comment [d36]:** There is much repetition in this section as in the one above. Collapse into one covering both treaty and facultative?



Facultative arrangements are sometimes established with less highly rated reinsurers than treaty risks, as a result of the competitive element, or the specialist nature of the risk.

There may be less good relationships with facultative reinsurers who do not participate in treaties.

There can be more scope for reinsurers less familiar with the market to write facultative reinsurance which may increase the risk that the reinsurance cover may be repudiated. Both reinsurance brokers and reinsurance companies can regard facultative risks as a first step in developing business in the local market, which can again lead to issues arising.

### 7.14.3 Non-Proportional Reinsurance Business Ceded

#### 7.14.3.1 *Purpose*

The solvency of the Insurance Industry in any country can be seriously tested by a catastrophic event.

The information in the non-proportional reinsurance appendices should help the Insurance Commission to assess the impacts of catastrophic events on the solvency of companies.

Other non-proportional reinsurance may be used to protect portfolios, and therefore to justify higher base retentions before proportional reinsurance is used.

#### 7.14.3.2 *Cross references*

None

#### 7.14.3.3 *Supplementary notes*

1.	A description of all doubtful recoveries/ bad debts
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#### 7.14.3.4 *Other points to check*

#### 7.14.3.5 *Other consideration*

The Insurance Commission may wish to consider the minimum criteria for the catastrophic risk protections that it wishes to see in place.

If the catastrophic risk protections look unsatisfactory, the Commission might ask what Scenario testing has been carried out (referring to IAIS guidance perhaps).

### 7.14.4 List of Reinsurers

#### 7.14.4.1 *Purpose*

These forms look at the relationship between each company and its reinsurers.

#### 7.14.4.2 *Cross references*

All entries in the List of Reinsurers forms should correspond to entries in the other reinsurance forms.

7.14.4.3 *Supplementary notes*

None

7.14.4.4 *Other points to check*

None

7.14.4.5 *Other consideration*

Looking across these forms for all companies in Jordan gives an idea of the exposure of each reinsurer to the market.

## 7.15 Life Insurance Actuarial Report

### 7.15.1 Purpose

Every insurance company, writing life business in Jordan, is required to ensure that an investigation is carried out by its actuary at the end of each financial year, including the valuation of its technical provisions.

### 7.15.2 Cross references

None.

### 7.15.3 Supplementary notes

None.

### 7.15.4 Other points to check

### 7.15.5 Other considerations

Most of the issues arising are relevant to one or other aspect of risk, and these are set out below, with the type of risk. In addition to these specific issues, particular attention should be paid to any changes in the information provided, compared with the previous year's returns, and consider whether such changes are reasonable and consistent with other information, contained elsewhere in the returns, or otherwise known about the company.

The following information is relevant to **capital risk**:

- Is there a large volume of non-linked business which includes any significant options or guarantees?
- Is there a large volume of linked business which includes any expense and, particularly, investment guarantees?
- Is there significant reliance on reinsurance financing to support the company's solvency position?

The following information is relevant to **reserve risk**:

- Do the methods used in creating and cancelling units, and determining unit prices for the allocation of units to policies, and the cancellation of units from policies, appear to be reasonable and consistent with policyholders reasonable expectations?
- Is there any apparent weakness in the valuation methodology adopted, or in any of the specific valuation assumptions made? In particular:
  - Has adequate provision been made for any options and guarantees?
  - Do mortality and morbidity assumptions appear to contain adequate margins for adverse deviations? Specifically, does the mortality assumption for any annuity business make appropriate allowance for future mortality improvements?
  - Do the interest rates used in the calculation of the mathematical provisions look reasonable?
  - Do the interest rate scenarios used to determine the Capital Required for Interest Rate Risks meet the latest guidance issued by the Commission?
  - Do the valuation assumptions made in respect of sterling reserves on unit-linked business appear to be reasonable?
- Have there been any significant changes made to valuation methodology or assumptions, and are these changes reasonable?
- Does the information given regarding the company's principles and practices in distributing profits to any with profits policyholders appear to be reasonable and consistent with policyholders reasonable expectations?

The following information is relevant to **asset risk**:

- Is there an unusually high Capital Requirement for Interest Rate Risks or cash-flow mismatching **reserve**?
- Is there a significant currency mismatch between technical provisions (other than those in respect of investment-linked benefits) and the corresponding assets **held**?

**Comment [d37]:** Not sure this information is collected in the absence of the 2004 changes.

**Comment [d38]:** Same comment as above.

The following information is relevant to **strategy risk**:

- Does the company have a limited product range or rely on one main class of business?

## 7.16 General Insurance Actuary's Report

### 7.16.1 Purpose

Every insurance company writing general business in Jordan, is required to ensure that an investigation is carried out by its actuary at the end of each financial year, including an assessment of the adequacy of its technical provisions.

### 7.16.2 Cross references

None

### 7.16.3 Supplementary notes

None

### 7.16.4 Other points to check

### 7.16.5 Other considerations

Many of the issues that may arise are set out below. In addition to these specific issues, particular attention should be paid to any changes in the information provided, compared with the previous year's returns, and consider whether such changes are reasonable and consistent with other information, contained elsewhere in the returns, or otherwise known about the company.

- Are any of the important changes discussed news to the Insurance Commission? What are the potential financial impacts of these changes?
- Is there any danger that key financial points will be omitted by any assumptions of immateriality? For instance small classes of business that are largely reinsured may have some reinsurance relationship or mismatch risk.
- Data quality can be a significant issue in all companies. The Insurance Commission should review the disclosures to assess whether the company is basing its technical provisions on reliable data. The Insurance Commission should encourage companies to improve their data, controls and management information systems as far as possible, where this is necessary.
- The Insurance Commission should review the information in this section so that it has a good understanding of the business of the insurer, the risks it is running and any changes that it has made to the methods or assumptions for calculating technical provisions.
- Calculation of the Unearned Premium Provision should be straightforward but if there is any indication that it has not been calculated in accordance with Article 7(A)-1 of the Basis for Calculating Technical Provisions Instructions of 2002 then this should be followed up. For annual policies where the insurer has agreed to accept the premiums in instalments (monthly for instance), the written premium should be the whole of the premium due under the policy for the year and the unearned premiums and outstanding premiums should correspond to this.
- Is there an URP? If a class of business is consistently loss-making, why isn't there a URP? It will be necessary to review all the information given in response to this question and to pay particular attention to changes in premium rates and policy benefits.
- Does the Catastrophic Risk Provision look reasonable as a percentage of the company's net retained risk in the event of a catastrophe? Do the assumptions and

**Comment [d39]:** Text below appears to be useful guidance, but will the information mentioned in the bullets be available to regulators in the absence of detailed prescribed reporting formats for the Actuary's report?

methods used to calculate the provision appear to be reasonable? Are the alternative quotes for catastrophe reinsurance consistent with the provisions?

- Have the case estimates been determined individually and are they undiscounted? Do the methods and assumptions used appear reasonable? How do the case estimates made by the company compare with any statistical estimates made by the actuary of the Reported Claims Provision? Have reserves established in the past been sufficient?
- Does the IBNR provision look reasonable as a percentage of the overall Outstanding Claims Provision (analysed by class)? Are the methods and assumptions that have been used appropriate?
- Have there been any significant changes made to valuation methodology or assumptions, and are these changes reasonable?
- Is a provision held in respect of any Asset Liability mismatching? How has this been determined (using Dynamic Financial Analysis?)
- Is there a significant currency mismatch between technical provisions and the corresponding assets held?

#### **7.17 Life Actuary's certificate**

##### 7.17.1 Purpose

This certificate is required only for a company which writes life business, and only in respect of that business. It consists of . . . (the Instructions #2 of 2002, Basis of Calculating the Technical Provisions specify that the Actuary's Certificate re technical provisions must accompany financial statements submitted by the company annually and semiannually. Content isn't otherwise prescribed.) If the actuary considers that any qualification, amplification or explanation is appropriate, this must be added to the certificate.

##### 7.17.2 Supplementary notes

None.

##### 7.17.3 Other points to check

Has the certificate been signed by the actuary appointed by the company under the Act?

##### 7.17.4 Other considerations

#### **7.18 General Insurance Actuary's Certificate**

##### 7.18.1 Purpose

This certificate is required only for a company which writes general insurance business, and only in respect of that business. It consists of . . . (same point as above—current Instructions don't specify content)

If the actuary considers that any qualification, amplification or explanation is appropriate, this must be added to the certificate.

7.18.2 Supplementary notes

None.

7.18.3 Other points to check

Has the certificate been signed by the actuary appointed by the company?

## **8 APPLICATION FOR A NEW LICENCE**

### **8.1 Statutory provisions**

Under Article (45) of the Insurance Regulatory Act of 1999, an insurance company is permitted to carry on insurance business in Jordan only if it has been granted a licence to do so by the Board of Directors of the Commission.

Detailed Instructions were issued as the [Instructions for Granting and Renewing the Licence to Transact Insurance Business Instructions No.(1) of 2003]. To obtain a licence, a prospective Jordan insurance company must submit an application to the Commission in a prescribed form that is to be determined in a Decision to be issued by the Director General. If and when granted, the licence shall be for up to the end of the year in which it is granted (i.e. up to a maximum of one year's duration) (Article (13) of the Instructions). New licences can only be given to companies carrying out only general business or only life business but not both.

Prerequisites for the granting of a licence are set out in the [Instructions for Granting and Renewing the Licence to Transact Insurance Business of 2003]. These include, among others:

- the company has submitted a valid application, including a 3 year Business Plan and financial statements;
- the company has a specified minimum level of paid up share capital;
- the company possesses a specified minimum level of guaranteed fund (though no minimum level has been specified to date);
- the Director General is satisfied that controllers, board members, the general manager, employees or an authorised manager of a Company are capable and appropriate and meet with the provisions of Articles (31), (32) and (33) of the Act;
- the company has supplied a certificate from the actuary, as required under Article (3) of the Instructions;
- the company has an appropriate reinsurance policy, a copy of which has been supplied to the Insurance Commissions in accordance with the {Reinsurance Instructions of 2002};
- that the structure, organisation and management of the Company are such as to promote sound and prudent management of the Company's business.;

- that the Company has in place risk management systems, including reinsurance arrangements, information technology systems, internal control systems, policies and procedures, that are appropriate to the complexity, size and nature of the Company's proposed business and that are adequate to monitor and control all material risks;
- that the Company has sufficient financial resources such that it is likely to be able to maintain the minimum solvency ratio and Technical Provisions, required by Article (35) of the Insurance Regulatory Act No. (33) of 1999, on an on-going basis, and for at least the first 3 years of operation, without recourse to further capital, even under reasonably foreseeable adverse assumptions as to future experience;
- that the Company has in place (or will have in place) agreements with each of its Agents, Brokers and reinsurers, and with any third party providing management, administration, investment or other insurance services to the Company, that are appropriate and provide adequate protection for the Company as to the charges to be incurred and the services to be provided under those agreements, the potential liability of the Company with regard to those services, and the continuity of those services in the event of the termination of the agreement;
- where the Company is part of a wider group, that the organisation, management and structure of the group is not such as to hinder the effective supervision of the Company by the Commission; and
- in the case of a branch of a foreign insurance company, that the foreign insurance company is authorised to transact the relevant classes of insurance in its home country, that it meets and (as far as can be determined) is likely to continue to meet the solvency requirements of its home country, and that it has appointed an Authorised Manager who is a fit and proper person, and possesses the appropriate integrity, competence, experience and qualifications for the position.

Similar requirements also exist for expansion of existing business in Article (17) of the Instructions.

Article (10) of the Instructions extends the requirements to foreign insurance undertakings wishing to carry on business in Jordan.

## **8.2 Objective of the Commission**

The objective of the Commission should be to take account of all relevant information and advice to seek to ensure that only those companies that are considered suitable and that have viable business proposals become licensed to write insurance business.

A similar comment also applies to extensions of authorisation. In this case, the Commission should have close regard to the claims and expense ratios experienced by company in respect of its existing business, its general standing, and whether there are any perceived problems with the extension of authorisation.

In order to meet this objective, it is essential that the Commission has access to detailed information on the proposed managers, controllers and directors of the company, and its proposed reinsurance program and reinsurers. It is recommended best practice that the

Commission seeks the advice of independent actuarial advisors in appraising licence applications.

Following the granting of a licence, it may be a good idea for the Commission to strengthen the level of its control over the company during its early years. Where this is not done, there should, as a minimum, be an “initial period” of supervision, during which the company’s business is monitored closely.

### **8.3 “Fit and Proper” Persons**

Under Articles (31) and (33) of the Act, to be granted a licence, a prospective company must ensure that key individuals have competence and experience in insurance and conform to various requirements.

These articles are set out in sections 8.3.1 to 8.3.2 below, with commentary under section 8.3.3.

#### **8.3.1 Article (31)**

It shall not be permitted for a person to become a controller, a board member, a general manager, an employee or an authorized manager in a Company, if that person:-

- A- Was convicted with a felony or a misdemeanour infringing integrity, trustworthiness and public morals or declared bankrupt without being rehabilitated.
- B- Was responsible, upon the discretion of the Board, for a gross violation of any provision of this Act or the Companies Act in his capacity as a general manager or a director in a Company, including the liability for causing a compulsory liquidation of an insurance company.

#### **8.3.2 Article (33)**

A- Competence and experience in insurance are prerequisites in the general manager of the Company, the Authorized Manager and the key employees therein. The Company shall provide the Director General with the details of the qualifications and experience of each.

B- If it is evident to the Board that the necessary competence or experience is not available in any of the persons mentioned in paragraph (A) of this Article, the Board may not approve the appointment, provided that such disapproval is justified.

#### **8.3.3 Commentary on Articles (31) and (33)**

The objective of the competence and experience test and additional criteria is to ensure that persons holding key positions in insurance companies, to the best of the Commission’s knowledge, have the necessary integrity, are competent, suitably experienced and trustworthy. This is one of the cornerstones of the system of regulation of insurance companies, and consequently in cases where the Commission is aware of information that casts doubt on the fitness of an individual for the particular post, it must be prepared to serve notice of objection. In other jurisdictions, these requirements may be referred to as the “fit and proper” test; i.e., applicants must have management that is “fit and proper” to run the company and respect the laws governing it.



In determining whether a person is fit and proper, their acceptability may need close consideration because of what is disclosed in their notification, or because of what is uncovered during routine enquiries, or because of what the Commission knows separately. In deciding a person's fitness, it is legitimate for the Commission to have regard to any views it may have formed at any time in its dealings with the person concerned.

One ground for objection in relation to a proposed controller is financial unfitness. Where the Commission has any doubts about the ability of the proposed controller on this ground, it should enter into early dialogue, and if necessary serve a notice of objection. Indications that a proposed new controller is financially unfit are, for example, that the acquisition of the target company is being funded by an unacceptably high level of borrowing, which will put undue pressure on the insurance company to yield up dividends. Acquisitions by private individuals and new companies that cannot submit accounts for the previous 3 years must always be looked at with great care.

It is not possible, nor probably desirable, to give an exhaustive list of the kinds of conduct which could lead to a finding of unfitness against an individual. However, the relevant issues include the honesty, integrity, knowledge and experience of an individual. By way of illustration, the following considerations may be relevant.

- **Non-disclosure.** This alone may not be sufficient reason for rejection but there could be dishonest concealment, which would make the individual unsuitable for many positions. Where enquiries reveal an omission from a notification, e.g. of conviction or bankruptcy, the Commission should always ask the individual whether its information is correct, and to comment on the omission and the circumstances of the matter.
- **Offences.** The significance of any offence known to the Commission should be considered on its merits, taking full account of all available information concerning the surrounding circumstances. Relevant considerations would include:
  - the nature of the offence – those involving dishonesty would probably be regarded more seriously;
  - the period of time since the offence – those occurring more recently would probably be regarded more seriously;
  - the individual's age at the time of the offence – those occurring at young ages would probably be regarded less seriously.
- **Bankruptcy.** Account should be taken of the surrounding circumstances, and particularly the nature of the individual's role and degree of culpability.
- **Experience.** In considering proposed appointments for chief executive or managing director, it is reasonable to expect such people to have had at least 5 years experience in the previous 10 years at a similar level or the next step down in an authorised insurance company that has carried on similar business. For a new director, it would usually be considered sufficient if at least a third of the directors have been directors of authorised insurance companies for at least 5 of the last 10 years. The absence of

**Comment [d40]:** Note: current law doesn't require scrutiny of the board of directors re competence and experience, only re previous convictions or infractions of law.

professional qualifications should not of itself be regarded as a bar to the holding of senior positions in insurance companies.

- **Other.** Examples might include:
  - the age of directors – the age and composition of the Board as a whole should be considered;
  - irresponsible behaviour, e.g. investing the assets of an insurance company in unsuitable, speculative directions; or delegating the management of the company to an agent whose fitness and propriety is itself in doubt; or character weakness, such as failure to resist a dominating management recognised as being engaged in doubtful or worse practices.

The Commission should always consider fit and proper in the context of the position held or proposed to be held. An individual may be perfectly fit and proper to serve as a manager of an insurance company but may not necessarily be fit and proper to act as its managing director or chief executive.

The Commission should bear in mind the timescale imposed on it for serving an objection, and act accordingly. It is recommended best practice for it to consider taking legal advice, particularly with regard to any notice of objection served.

It is important that where adverse information on a person comes to light **at any time**, the Commission should be able to take appropriate regulatory action on fit and proper grounds. It should not be precluded from taking action against an **incumbent** because it may have expressly or implicitly accepted the person as being fit and proper at some previous time, e.g. when granting a licence or upon a change of control.

In the case of an incumbent, it may be that once fit and proper action commences, the individual resigns their position. If so, further action is clearly unnecessary: the ground for exercising the action would no longer exist. There is also always the option of taking action against the individual out-with the provisions of the Law, e.g. reporting a professional to his disciplinary body; reporting evidence of a crime to the police; or taking some lesser action in less serious cases or where there is doubt about the culpability of the individual concerned, e.g. a warning letter or a letter indicating to a company that the Commission would be content to see the individual appointed to a different position.

It is important in any fit and proper proceedings for the Commission to avoid being seen as both prosecutor and judge. Any potential bias should thus be avoided (e.g. a separate officer should be used for oral hearings, etc). It is also critical to be scrupulously fair in dealing with the individuals concerned, making sure that they understand the case being made against them and have full opportunity to answer this. In forming a judgement, the Commission should also be scrupulous in seeing that the case for the absent person is fully and fairly deployed.

It may be desirable for the Commission to notify other regulators, including foreign regulators, in cases in which a person has been found to be not fit and proper. It is also recommended best practice for the Commission to post details of the circumstances surrounding fit and proper actions to the **precedents register**.

## **8.4 Conflicts of Interest**

Under Article (32) of the Act, to be granted a licence, a prospective company must ensure that key individuals avoid any potential conflict of interest.

This article is set out in sections 8.4.1 below, with commentary under section 8.4.2.

### **8.4.1 Article (32)**

A- The chairman of the Company, members of the board, the general manager, the Authorized Manager or a deputy thereof, or any manager or senior staff therein, shall not be permitted to:-

- 1- Participate in the management of another competing or similar insurance company.
- 2- Compete with the business of the Company or perform any action or activity conflicting with the interest of the Company.
- 3- Function as an insurance Agent or as an Insurance Broker.
- 4- Receive a commission from any act of insurance business.

B- The general manager or any employee in the Company shall also be prohibited from being a member of the board as a representative of any other shareholder in that Company.

### **8.4.2 Commentary on Articles (32)**

It is a pre-requisite for the granting of a licence that the Director General is satisfied that the key staff avoid any conflict of interest between their roles in the insurance Company and any other roles they may undertake.

The insurance commission may wish to interpret section A-2 fairly widely.

Other possible conflicts of interest include:

- Acting as reinsurance broker, or receiving reinsurance commissions.
- Owning or working with any service company that is used by the Insurance company (e.g. a garage doing motor repairs)
- Offering insurance on un-commercial terms to any entity that a key member of staff has a financial interest in.

## **8.5 Format and contents of application**

The application for a licence must be prepared in accordance with the Decision made under Article (3) of the [Instructions for Granting and Renewing the Licence to Transact Insurance Business], and the Commission should check compliance with this requirement. This should include the financial information in the three year business Plan.

## **9 RENEWAL OF AN EXISTING LICENSE**

### **9.1 Statutory Provisions**

Under Article (45) of the Insurance Regulatory Act of 1999, an insurance company is permitted to carry on insurance business in Jordan only if it has been granted a licence to do so by the Board of Directors of the Commission.

Detailed Instructions were issued as the [Instructions for Granting and Renewing the License to Transact Insurance Business of 2003].

To renew its licence, a Jordanian insurance company must submit an application to the Commission in a prescribed form that is to be determined in a Decision to be issued by the Director General. If and when granted, the licence shall be for one year's duration (Article (13) of the Instructions).

An application to renew the insurance licence must be submitted 45 days before the end of the year (that is by 16 November each year). The requirements for granting the renewal of a licence are set out in Article (15) of the [Instructions for Granting and Renewing the License to Transact Insurance Business of 2003]. These include, among others:

- the Director General is satisfied that board members, the general manager, key employees and authorised signatories of a Company are capable and appropriate and meet with the provisions of Articles (31), (32) and (33) of the Act;
- the company has supplied projected financial statements for the next financial year;
- the company has an appropriate reinsurance policy, a copy of which has been supplied to the Insurance Commissions in accordance with the {Reinsurance Instructions of 2002};
- Any data or documents requested by the Insurance Commission, and not received the year must be submitted with the application to renew the licence

## **9.2 Commentary**

The requirements for a new company with respect to competence and experience and avoidance of Conflicts of Interest in section 8 above apply just as much to a company renewing its licence, as to a new company obtaining one for the first time.

However unlike the 3 year business plan required by a new company, there is no requirement for the one year projection to be certified by an actuary or by an auditor.

## **10 INTERVENTION POWERS**

### **10.1 Statutory provisions**

The majority of the Board of the Insurance Commission's powers to intervene in the affairs of an insurance company are contained in Article (41) of the Insurance Regulatory Act of 1999.

#### **10.1.1 Article (41)**

A- Where sufficient information is available for the Director General indicating any of the following:-

- 1- That the Company did not or may not fulfil its obligations or where the Company fails to continue its business.
- 2- That the Company committed a violation to the provisions of this Act, Regulation, Instructions or Decisions issued by virtue thereof.
- 3- That the necessary arrangements of the Company to reinsure risks are not enough, or that such arrangements are not taken.
- 4- That the Company has a gross violation of the business plan submitted to the Director General, according to which the License was granted.
- 5- That the total losses of the Company exceeded (50%) of its paid up capital.
- 6- That the Company is not transacting business for a period not less than one year, without justified or legitimate reason.

The Director General shall validate such information.

B- If it was evident to the Director General that the information is accurate, he shall either refer the case directly to the Board to take the necessary measures in respect thereof, or ask the Company to take specific measures to rectify its status within the period determined by him; otherwise the Director General shall refer the case to the Board to take such measures, including:-

- 1- Prohibit the Company from issuing more insurance contracts, or prevent it to transact business in a certain class of insurance or more.
- 2- Impose a maximum for the amount of premiums procured by the Company from Insurance Policies issued thereby.
- 3- Maintain in the Kingdom assets, the value of which equals all the net obligations of the Company arising from its transactions or a percentage of such value.
- 4- Restrict any of the investment activities of the Company related to the Solvency Margin or oblige the Company to liquidate its investments in any of these activities to serve this purpose.
- 5- Request from the Company or the head office of the foreign insurance company, as the case maybe, to take the necessary measures to rectify the administrative situation of the Company, including the removal of the general manager, the Authorized Manager or any key employee therein.
- 6- Remove the chairman of the board of directors of the Company or any member of the board if it was proven that he is responsible for the violation.
- 7- Dissolve the board of directors of the Company and appoint a neutral temporary administrative committee of competence, and appoint a chairman and deputy for such committee. The functions and authorities of which shall be determined for a period not exceeding six months renewable for a term not exceeding one year, if necessity dictates. The Company shall bear the expenses of the committee as determined by the Board. Upon the completion of the assignment of the committee, a new board of directors shall be elected in accordance with the Companies Act.
- 8- Take the necessary procedures to merge the Company with another Company, upon the approval of the Company with which the merger is sought.
- 9- Suspend or cancel the License of the Company.
- 10- Rehabilitate the Company.
- 11- Liquidate the Company.

### 10.1.2 Commentary on the Statutory Provisions

Article (41) of the Insurance Regulatory Act gives the Insurance Commission wide-ranging powers to respond to any transgression committed by an insurance company.

The clauses in Article (41) – A are not precisely defined, and are therefore open to quite a lot of interpretation. The Insurance Commission should seek to ensure that they are interpreting the Act in a way that is consistent with their objectives, and which is, and is seen to be, consistent across all the companies in the market.

Article (41) – B allows the Commission to:

- maintain the full value of the technical provisions in assets within the Kingdom;
- withdraw a company’s licence to write all or some classes of business;
- Take stronger actions as necessary, including removing Board member and/or key employees, dissolving the board, rehabilitating the company, arranging a merger, or in extreme circumstances liquidating the company.

However, there are no stated powers in respect of intermediaries, brokers or agents;

It is important for the Insurance Commission to have these powers, but equally it is essential for the orderly function of the Insurance marketplace that they be exercised judiciously and consistently.

Other important powers also exist elsewhere in the Act. These include:

- Article (40)-B provides the power to obtain information from a company’s auditors directly.
- Article (37)-C provides the powers to enter a company’s premises to examine books of account, computer files and other records and to take copies of them, and to carry out on-site inspections;

Sanctions that may be imposed for non-compliance with various parts of the Act, Instructions and Decisions are set out in Articles (87) to (94) of the Act. A summary of offences and sanctions under the Law is provided in section 10.9 of this manual.

## 10.2 General guidance

It is important that all actions taken by the Commission are within the powers conferred on the Board of the Commission by the Insurance Regulatory Act of 1999, and that adequate grounds exist for exercising its powers. Due to their gravity, only the Director General and the Board of the Commission should take decisions relating to the exercise of intervention powers.

The Commission’s objective should be to ensure that intervention powers are used when it is necessary for protecting the interests of policyholders, but not in such a way as to unnecessarily restrict the operation of a company. It should be borne in mind that requirements are restrictive and may be costly for the company, and also potentially for the Commission to police. However, whilst they should never be used unnecessarily, requirements should be imposed in proper cases, with a suitably robust approach adopted where necessary.

**Comment [d41]:** The provision doesn’t clearly place a duty on the auditor.

Requirements should be imposed on a company only because some aspect of its affairs is causing regulatory concern. This should be interpreted widely, however, and might include circumstances in which the company was merely new, newly re-authorised or had recently undergone a change of control.

Companies are often most vulnerable during their early years, and for this reason it may well be appropriate to impose requirements on **new companies** to strengthen the Commission's level of control over them during this period. Any decision on the precise requirements to be imposed should normally be taken only after consultation with the company, which might be provided with a draft of them for comment, and perhaps with independent actuarial advisors. The aim of imposing requirements in these circumstances is to protect the interests of policyholders. Particular care is likely to be required in respect of new subsidiaries of established companies, where tax and other factors might have influenced the new corporate structure.

Requirements imposed following a **change of control** will depend on the individual circumstances of the change; the standing of the new controller; its plans for the future development of the company; and generally the dangers that could arise for the company from the change.

Imposition of requirements in **other circumstances** is likely to be a delicate matter. Failure to impose appropriate requirements soon enough could result in policyholders suffering an avoidable detriment. But the imposition of unnecessary or inappropriate requirements might simply exacerbate the company's difficulties. Careful judgement is therefore called for. It is vitally important in these circumstances to check that proper grounds exist for exercising an intervention power, implying the need for the Commission to take legal advice where necessary.

Consideration should be given to whether the company should be approached before the requirements are imposed. This is generally sensible, but in some circumstances the urgency of the situation will preclude prior negotiation with the company. The requirements themselves should always be imposed through a **formal notice** signed by the Director General, which must **state the ground** on which the action is being taken.

The objective of imposing **restrictions on investments** is to ensure that the financial resources of a company are invested only in suitable assets. Suitability should have regard to both security and liquidity. Such restrictions would generally be solvency driven, and require the consent of the Director General before the company could make investments or dispose of assets. The investment of assets (or others) unsuitably might give grounds for taking other intervention action. For example, it might indicate an ulterior motive, raising concerns as to whether the controllers of the company are fit and proper.

The objective of exercising intervention powers relating to **obtaining information** is to ensure that the Commission is fully informed of a company's financial affairs or other aspects of its activities, which are giving cause for regulatory concern. Account should be taken in exercising such powers of the extent of concern and the potential implications for policyholders. The Commission should normally try to ascertain whether there exists any validation of those concerns, or corroboration of any allegations that may have been made.

It may be appropriate in some circumstances to arrive at a company unannounced, in others to give notice. All conversations, and explanations given of documents, should be noted carefully: it may be necessary for the Commission to give evidence in subsequent civil or criminal proceedings. A report should be prepared afterwards, summarising the results of the visit and making recommendations for actions to be taken to alleviate the regulatory concerns. All information gathered is, of course, strictly confidential.

It should be borne in mind that the same intervention power might be used for more than one purpose: e.g. to seek to prevent a risk occurring, and to respond if that risk in fact crystallises. Formal disciplinary action will often not be needed to satisfactorily address issues arising; however, this should be taken when necessary.

It is recommended best practice that the Commission posts details of the circumstances surrounding the exercise of intervention powers to the **precedents register**.

### **10.3 Restoration plan following breach of the minimum solvency ratio.**

The Director General does not have the explicit power to require a company to produce and submit to him for approval a plan for the restoration of a sound financial position if it is not meeting the minimum solvency ratio Capital Available to Capital Required. However, the powers granted under Article (41) of the Act are sufficiently wide-ranging that the Director General can impose this requirement if he sees fit.

The minimum solvency ratio is 150% of the Capital Available to the Capital Required, as defined in Article (4)-B of the [Solvency Margin Instructions of 2002].

In the case of a company writing life insurance, the actuary should be given the responsibility of preparing and monitoring the materialisation of such a plan for the life business. The Insurance Commission may also wish to consider whether the actuary should be asked to produce the plan in respect of general business

It is not possible to specify the contents of such a plan, as the circumstances of each individual case will vary. To be acceptable, however, the plan should provide for the restoration of cover for the minimum solvency ratio within a specified timescale, which should be clear to both the Commission and the company.

What is an acceptable timescale will depend on the severity of the breach of the minimum solvency ratio and on the remedial action required or proposed:

- sometimes a breach of the minimum solvency ratio may be of a “technical” nature, e.g. resulting from a temporary over-concentration, and resulting large-scale inadmissibility, of investments. Such a breach might well be solved just by rearranging assets, in which case a reasonable timescale would be that during which the necessary trading of assets could realistically be completed;
- a similar example would be where the remedial action involved increased use of reinsurance; in such a case, a reasonable timescale would be that during which the necessary reinsurance could be negotiated and effected;
- in cases where an additional injection of capital is required, the timescale should generally be short, especially where there exists a large majority shareholder;



- in cases involving voluntary closure to new business, the timescale might allow scope for the company to seek to sell any tied sales force, for example.

If and when the plan is approved, the Commission should monitor progress against it carefully. Exercise of other intervention powers might be considered in this context, e.g. accelerating the next set of annual returns or requiring more frequent reporting for a temporary period. The primary objective of the Commission should be to identify as early as possible any material departure from the plan, and/or any time at which the likelihood of its eventual materialisation falls below an acceptable level.

In such a circumstance, the Commission has the grounds to exercise, and should give serious consideration to exercising, its power to withdraw the company's licence under Article (41) of the Act. However, before doing so, the company should normally be given the opportunity to explain the reasons for the emerging non-materialisation of the plan and how these might be overcome, perhaps by means of the adoption of an alternative plan.

#### **10.4 Short term finance scheme required where solvency is seriously impaired**

There is no defined level of solvency ratio at which the Insurance Commission should take stronger action than the restoration plan covered in the previous section.

We suggest that Director General require a company to produce and submit to him for approval a short-term finance scheme if the solvency ratio goes below 110% (where the solvency ratio is the ratio of the capital available to the capital required).

In the case of a company writing life insurance business, the Actuary should be given the responsibility of preparing and monitoring the materialisation of such a plan. The insurance commission may also wish to consider whether the actuary should be asked to produce the plan in respect of general business

Similar comments as in the previous section apply to such a scheme but there is a greater level of urgency due to greater severity of the company's financial weakness. To be acceptable, the plan should provide for the restoration of cover for the minimum solvency ratio within a short period (say within 2 weeks), which should be clear to both the Commission and the company.

#### **10.5 Withdrawal of Licence**

**The grounds on which the Director General may withdraw a company's licence to carry on insurance business are set out in Article (41) of the Act, reproduced above in Section 10.1.** The decision to withdraw the licence should be adequately justified and communicated to the company. Although not defined in the law, it may in practice be subject to both representation and appeal procedures. However, the Board of the Insurance Commission may, where this is justifiable on the grounds of public interest or protection of policyholders, order the immediate cessation of the company's business pending the completion of these procedures.

Article (41) – B-1 of the Act provides for partial withdrawal of a licence, restricted to a specific class or classes of business.

Following withdrawal of its licence, a company is prohibited from entering into any new contracts. However, it may be permitted to continue to receive premiums due under existing contracts and to meet its obligations under those contracts.

The regulatory objective of withdrawing a licence in an **ongoing situation** is to limit the risk to prospective new policyholders, e.g. due to serious concerns over a company's solvency or the fitness of its management. In deciding whether to take such a step, the Commission should balance the interests of these prospective new policyholders with those of existing policyholders, whose position could potentially be adversely affected by the resulting cessation of new business. It is recommended best practice for the Commission to seek advice from independent actuarial advisors in making such a decision in relation to a company writing life insurance business.

Withdrawal of a licence can also be appropriate in more benign circumstances. It should, for example, be the Commission's general policy to persuade companies to relinquish their licence in respect of classes of business they are **not writing**. Not allowing licences to remain unused for an indefinite period is also sensible, to prevent companies suddenly reactivating lines of business that have remained dormant for years without providing prior notification and justification to the Commission. This is directly relevant to the financial overview of a company, as an unused licence could lead to greatly increased business through reactivation without disclosure for up to 5 months (if the reactivation started on 1 October, then the Insurance Commission would first know about it on the following 28 February).

Before withdrawing a licence in respect of a given class of business, the Commission should write to the company to notify its intention to do so and invite the company to object if it wishes. This is sensible, as the Commission cannot be completely sure that the business is not being written, or will not be in the near future, or in circumstances where it is not being written that valid reasons do not exist as to why not, e.g. the risks for a given class may not be reported as such because they are ancillary risks included within other classes. In such circumstances, it would be appropriate for the licence for that class to remain in force.

The Commission should check periodically that a company is carrying on all the classes of business for which it is authorised. If not, and the matter is not already explained or understood, the Commission should write to the company to explain the position.

It is probably sensible for general business pure reinsurance companies to retain a licence for all classes they had originally to prevent their accepting business for which they are not licensed inadvertently. Such a position could arise in respect of non-proportional treaty business, for example.

If all of a company's business has been transferred to another company, its licence should be withdrawn as soon as possible after the **transfer of business** has taken place, unless the company is to be sold immediately to another insurance company that intends to start business again within, say, 3 months.

## 10.6 Suspension of Licence

The grounds on which the Director General may suspend a company's licence to carry on insurance business for a period of up to a year are set out in Article (47) of the Act.

These are:

- That the Company committed a violation to the provisions of the Act, Regulation, Instructions or Decisions issued by virtue thereof;
- The Company did not meet some of the conditions required for the license granted to the Company by virtue of the provisions of this Act.
- The Company has not transacted business in any of the insurance classes included in the license, or stopped to transact this business for a year.
- The Company has failed to fulfil its financial obligations.
- The Company has refrained from enforcing a final judgment related to an insurance contract.

The decision to suspend the licence should be adequately justified and communicated to the company. However, it is not clear under what conditions a licence would be suspended rather than withdrawn under paragraph 10.5 above.

## **10.7 Rehabilitation Plan**

### **10.7.1 Overview**

There are circumstances under which it may be apparent that the company on its own may not be capable of rescuing itself from its financial predicament, but where the business, or parts of the business are fundamentally sound and may therefore be rescued or rehabilitated.

It is not possible to set out all circumstances where this could arise, but fundamentally the existing Board will have lost the confidence of other stakeholders including the Insurance Commission to rectify any problems that may exist.

### **10.7.2 Statutory Provisions**

Article (41)(B) (10) permits the Director General to put the company into rehabilitation if its financial condition is sufficiently poor.

There is no precise definition of the circumstances which would allow the Board of the Commission to decide to take this fairly drastic action.

Articles (60), (61), (62) and (63) of the Act set the process to be followed in order to rehabilitate an insurance company.

## **10.8 Liquidation of an Insurance Company**

### **10.8.1 Overview**

Insolvency and liquidation are relevant to regulation for two reasons:

- there are obvious implications for existing policyholders if an insurance company becomes insolvent;

- liquidation may itself be part of the appropriate regulatory response to events. In particular, it may be desirable to liquidate an insurance company to protect not just the interests of existing policyholders but also those of prospective new policyholders who might be adversely affected if the company were allowed to continue to trade.

The primary objectives of the Commission should be to prevent insolvent insurance companies from continuing to trade, and to seek to ensure that any liquidation of an insurance company is carried out in the best interests of its policyholders.

Liquidation can take place on a voluntary or compulsory basis. The latter involves a court process, and requires the petitioning of the court. The Board of the Insurance Commission is the only competent authority to issue a decision to liquidate an insurance company under Article 64(A) of the Act. The liquidation process is likely to be a very lengthy and expensive one. Alternatives to liquidation may exist (e.g. temporary administration, transfer of business, reduction in the value of contracts, various types of compromise arrangements) and the Commission should pursue their possible suitability in a particular set of circumstances.

Legislation relating to liquidation is invariably complex, not least because of the way in which company law and insurance company law inter-relate. It follows that the Commission would almost certainly need to take legal advice in a liquidation situation.

#### 10.8.2 Statutory provisions

Article (41)(B)(11) permits the Director General to put the company into liquidation if its financial condition has deteriorated to a sufficient degree that no other course of action is deemed possible.

Articles (64) to (82) of the Act set out the process to be followed to liquidate an insurance company.

### **10.9 Non statutory intervention**

The Commission may also consider taking action on a non-statutory basis.

In considering whether to take such action, regard should be had to whether a prohibition exists either explicitly or implicitly under Jordan law. Also, where express statutory powers exist to achieve a desired end, then they should generally be used. This is because while exercise of statutory powers is discretionary, the Commission has a duty to give proper consideration to whether that discretion should be exercised; and failure to exercise such powers in appropriate circumstances could result in criticism for the Commission.

The following subsections provide examples of forms of non-statutory intervention that are quite commonly used.

#### 10.9.1 *Acceptance of undertakings*

There are circumstances where a view can properly be taken that it is in the best interest of policyholders not to invoke statutory powers but to try to achieve the same result by accepting an undertaking from a company or its controllers to take, or to refrain from

taking, a particular course of action. For example, it is not unusual to accept an undertaking from a company to cease writing new business. This has the advantage of avoiding the delay inherent in taking statutory intervention action to achieve this.

Although in legal theory it may be possible to bring an action for a breach of an undertaking, this should not be relied upon in practice. Therefore, an undertaking should be accepted only where it is believed it will be honoured. Only in exceptional circumstances should an undertaking by a controller to support a company financially influence the Commission's decision making.

A breach of an undertaking does not constitute a criminal offence. However, it may well give rise to circumstances in which the person who has breached the undertaking is not held to be "fit and proper" to hold their office in the company. It may also provide evidence for there being public interest in the company being liquidated.

If it is possible to take an undertaking from a company's solicitors, this course of action should be followed. As a breach of an undertaking is particularly serious in the case of a solicitor, he or she will be extremely unlikely to give such an undertaking if the matter is not entirely within their control. An undertaking "to use their best endeavours" is standard in many cases for this reason, and is, in many circumstances, acceptable wording.

A company should not be led to believe that the Commission has the power to demand an undertaking. If one is accepted, it should be made clear to the company that this is without prejudice to the exercise by the Commission of any of its powers under the Insurance Regulatory Act.

#### 10.9.2 *Suggesting a course of action*

There is no legal bar on the Commission suggesting a course of action to a company, or even seeking to persuade it to take a particular course of action that will alleviate the Commission's regulatory concerns. Again, however, it should not be implied that the Commission has the power to insist on this course of action.

Great care should be taken to ensure that the Commission does not find itself acting as a "shadow director". A shadow director is a person in accordance with whose directions or instructions the directors of a company are accustomed to act. Although it is unlikely that the Commission would be held to be acting as a shadow director, there are two sets of circumstances in which it could become exposed:

- in a "white knight" situation where a company is considering going into liquidation and the Commission encourages it to defer taking this action until a purchaser can be found. The directors should not be led to believe that they can abdicate their responsibility for the affairs of the company in favour of blindly following the Commission's lead;
- in a situation in which the Commission is minded to liquidate a company but holds off whilst the company takes steps to prevent this being necessary. The initiative in these cases should come from the company, and the situation not be allowed to arise where it could be claimed that the directors were acting on the instructions of the Commission, as a condition of its not presenting a petition.

### 10.9.3 *Unauthorised companies*

It may sometimes be necessary to mount a statutory investigation followed by liquidation proceedings, particularly where the public is seriously at risk, in relation to companies that are, or might be, carrying on insurance business without a licence. Sometimes, however, this situation might be dealt with without recourse to statutory powers.

It is quite possible for activities that may be unauthorised business to be brought to the Commission's attention. This might involve its being provided by a third party with a copy of literature distributed by a company. It would, in these circumstances, be necessary for the Commission to form a view as to whether the activities set out in the literature constituted insurance business.

If there is no doubt that they do, the company should be told that such is the view of the Commission, and an assurance sought that the activities will cease. Action can be taken under statutory powers if the company is defiant. Carrying on insurance business without a licence is an offence under Article (25) of the Act.

If there is doubt, further explanations should be sought from the company. This should be regarded as a fact-finding exercise, the object of which is to gather enough information for the Commission to form a view.

### 10.9.4 *Unprofessional conduct*

Occasionally, evidence of unprofessional conduct by accountants, lawyers, actuaries or other professionals may come to the attention of the Commission. Subject to any legal constraints on disclosure, consideration should be given to reporting the matters to the appropriate professional organisation.

### 10.9.5 *Requests for additional information*

Although the Act provides for the filing of returns by companies and statutory powers for the Commission to obtain information and require production of documents, there is no bar on its requesting additional information on a non-statutory basis.

## 10.10 **Summary of offences and sanctions under the Law**

### 10.10.1 Penalties within the Insurance Regulatory Act 1999

Penalties for violations of specific provisions are set out in Articles 87 through 95. They provide minimum and maximum amounts for financial penalties, as well as the possibility of assessing multiple fines for repeat offences. The table below summarizes these provisions; see the Act itself for precise wording in the event that penalties are being considered by the Commission.

Article 95 provides for appeals by interested parties before the High Court of Justice, within thirty days from the day a Decision (penalty) was issued.

<b>Article</b>	<b>Article breached</b>	<b>Description of the Article</b>	<b>Fines</b>
87	25	Insurance may only be transacted by an approved insurance company	JD 50,000 - 500,000
	26-B	Companies must abide by Instructions issued by the Insurance Commission	
	27 – A&B	All direct insurance taken out on risks located in Jordan must be taken out with Jordanian insurance companies, except that relating to airlines and aircraft owned by Jordanian companies	
	45-A	Companies may not transact Insurance Business before they have received a licence from the Commission	
	49	Companies may not transact Insurance Business if their licences have been cancelled or suspended by the Insurance Commission; contracts made before cancellation/suspension are valid and the company remains liable.	
88	36-A	Actuaries have to be licensed by the Insurance Commission	JD 20,000 - 40,000
89	33-B	Key employees and Board members have to be approved by the Insurance Commission, and may not be if they lack the necessary experience or competence	JD 5,000 - 20,000
	39	Policy documents must be approved by the Insurance Commission	
	53	Insurance business may not be transferred to another Insurance company without the permission of the Commission.	
	54	Agents must provide the commission with a copy of their contract with the company, and may only work for one company	
	55	Insurance and Reinsurance Brokers need to be registered with the Commission	
90	28	A company may open a branch inside or outside the Kingdom, and may move its office location, subject to instructions from the Commission	JD 10,000 - 20,000
	31	A Board member may not have had a felony conviction or certain misdemeanors or have been held responsible by Commission for the Gross violation of this Act or the Companies Act.	
	32	Key staff and board members must avoid any conflict of interest	
	44	No more than 2% of the premium income may be used to pay for services from a Head Office outside Jordan, for a Jordanian branch of a foreign insurance company.	

	46	Companies are only allowed to reinsure to other Jordanian regulated companies, if that company is authorised to write that class of insurance business.	
91	23 - H,I,J	The company does not maintain adequate records, or professional codes of conduct and ethics are not followed	JD 1,000 - 10,000
	30	All employees are Jordanians, unless specifically approved by the Director General and the Ministry of Labour where they have experiences and qualifications not available in Jordan	
91	34	All key employees to be notified to the Commission. Any key vacancies to be filled within 60 days. Other provisions re Board chairman election, resignation of Board.	JD 1,000 - 10,000
	36-B	All companies licensed to transact life business must appoint an actuary within one month of authorisation, and notify the Commission with one month of the appointment	
	40	The auditor must advise the Commission of any problems found with the company	
	42	A branch of foreign insurance company must appoint an Authorised Manager to act on its behalf in Jordan and provide returns including foreign branches and/or subsidiaries if appropriate	
	43	The Authorised Manager of a branch of a Foreign insurance company must file a document with the Commission showing that he or she has the powers to issue policies, pay claims, represent the company at before the Commission and at court, and to receive all correspondence on behalf on the company	
	58	Merging companies must carry out prescribed procedures	
92	-	Any person who has refrained from providing the Commission or the Director General with the documents, information and data that ought to be submitted according to this Act, the Regulations and Instructions issued by virtue thereof, or hindered or prevented the Director General, or the person authorized thereby, to implement his functions and authorities stipulated in this Act, the Regulations and Instructions issued by virtue thereof, interfered to prevent them from obtaining the information necessary to perform their duties, declined to provide them with such information, or failed to do so within the specified period.	JD 500 - 5,000
93	-	The liquidator shall be subject to a fine if he violated any of the obligations imposed on him pursuant to the provisions of this Act, Regulations and Instructions issued by virtue thereof.	JD 1,000 - 10,000

**Comment [d42]:** 23 HIJ provides for the Board to issue instructions in these areas; it doesn't relate to the Company at all. However, it seems to be inferred that a company violating these instructions is subject to penalties.



94	All excluding the above	This is a catch-all provision, that applies to all Instructions and Decisions issued under the insurance Regulatory Act, as well as all other Articles within the Act not mentioned in Articles (87) to (91)	JD 1,000 - 10,000
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## 11 ON-SITE INSPECTIONS

### 11.1 Introduction

In order to aid the effective supervision of insurance companies the Insurance Commission should undertake on-site inspections at the offices of insurance companies.

On-site inspection, whether by the Insurance Commission or its representatives, is an important part of the supervisory process, closely related to the on-going monitoring process. It provides information that supplements the analysis of the financial and statistical information sent to the Insurance Commission by the insurance or reinsurance company. On-site inspection is more effective if supported by market information and statistics derived from the analysis of the annual accounts and returns and other market intelligence.

On-site inspection aids the capture of reliable data and information about a company in order to help assess a company's current and prospective solvency and provides an opportunity to gain some understanding of the company's business objectives and plans.

In addition, on-site inspection might enable the supervisor to obtain information and detect problems that cannot be obtained or detected through on-going monitoring of financial returns. For example

- (a) in the case of companies experiencing asset trouble, accounting irregularities or deficient management, it enables the supervisor to identify problems that the company might be ignoring or hiding;
- (b) it offers the Insurance Commission the opportunity to have a personal relationship with the managers, which might inform an assessment of their fitness and proper-ness;
- (c) it enables the Insurance Commission to assess the management's decision-making processes and internal controls;
- (d) it can dissuade companies from pursuing activities, which are either illegal or improper;
- (e) it provides the Insurance Commission the opportunity to analyse the impact of specific regulations and, more generally, to gather information for benchmarking.

On-site inspection is also of great assistance in dealing with companies' problems. For example, the supervisors:

- (a) may be able to persuade the companies' management to take action to avoid current or future problems through dialogue during on-site inspection, which may be more efficient than through regulations;
- (b) can use on-site inspections as an opportunity to provide companies' management with information, especially concerning new legislation which might need to be explained in order to avoid misinterpretation.

The guidance set out below is to assist the Insurance Commission with some general supervisory standards for the conduct of on-site inspections. As the Insurance Commission gains experience from carrying out on-site inspections it may be appropriate to update the guidance. The guidance is divided into three main parts:

- (a) the most important objectives of on-site inspections;
- (b) a description of the on-site inspection procedure;
- (c) the organisation of the on-site inspection process.

## 11.2 Key Objectives of On-Site Inspections

Generally speaking, the key objective of any on-site inspection is the appraisal of the company's current and prospective solvency. More specifically, the objective is to

- (a) identify the risk profile of the company,
- (b) the controls that the company has in place to manage those risks
- (c) to detect any problem that may affect the company's capacity to meet its obligations towards policyholders in the short and long term.

### 11.2.1 Risks that companies are potentially exposed to are listed below. See Section 4.2 for a detailed description of each type of risk.

- Capital risk, including: -
  - Mortality/morbidity risk
  - Expense risk
  - Underwriting risk
- Reserve risk
- Asset Risk, including:

- Market Risk
- Currency Risk
- Mismatching risk
- Credit Risk
- Reinsurance Risk
- Liquidity Risk
- Strategy/environment risk, including:
  - Legal risk –
  - Tax risk –
  - Regulatory risk –
- Control/operational risk, including:
  - Dominance risk
- Group/contagion risk

#### 11.2.2. The controls that the company has in place to manage risks

A number of the risks set out above are interrelated and actions taken to manage and control one of these risks may also help in managing other related risks. However, the interaction between the different risks is more complicated than the groupings set out below and this should be borne in mind.

##### *11.2.1.1 Capital risk, Market risk, Currency risk, Mismatching risk, Credit risk, Liquidity risk*

These risks all relate to the investment of the company's assets. Following an appropriate investment policy is of fundamental importance to a company's ability to meet its liabilities in a variety of different possible scenarios for the returns on different asset classes. It is important that the company has adequate systems in place to establish a suitable investment policy, to update it as required and to monitor that it is being followed. In setting the investment policy the management must have regard to the risks above as well as to other investment objectives that it may have.

##### *11.2.1.2 Mortality/morbidity risk, Expense risk, Underwriting risk, Reserve risk, Reinsurance risk.*

A company's ability to meet its liabilities will depend primarily on the premiums that it charges for the benefits granted. It is important therefore that the company has adequate systems and controls to monitor the appropriateness of the premium rates charged. This will encompass assessing the underwriting risks taken and charging for them appropriately. Similarly for the other elements that need to be taken into account in setting premiums such as investment returns, expenses, tax, options and guarantees and profits. The level of expenses is a particular risk that will also be relevant to the Strategy/environment risk and Control/operational risk.

The company will need to consider appropriate reinsurance arrangements to reduce the level of risks that it runs. This is likely to be of particular importance for general insurance business. It is important that the company has adequate systems to establish a proper reinsurance program to control its risk exposures. The reinsurance arrangements may need to be allowed for in setting the premium rates charged to customers. It will also be necessary to consider the ability of the reinsurer to meet its liabilities.

Establishing adequate levels of technical reserves is also of fundamental importance to the solvency of insurance companies. For life business, the appointed actuary system, detailed requirements in the Law and actuarial monitoring all act to try to ensure that reserves established are adequate. However, for general insurance the position is less well defined and it is important that a company has proper systems to establish adequate reserves and that the manager responsible for this is sufficiently senior and independent of the underwriters.

In setting premiums the company will also need to take account of its overall ability to finance the desired level of new business in the context of its existing solvency position and so this is also relevant to the Strategy/environment risk.

#### *11.2.1.3 Strategy/environment risk*

Companies should have in place adequate planning systems and budgets covering all facets of its operations for at least the next three years. These should show the effects on the company's solvency position of the strategy being followed. The plans should also illustrate the effects on solvency of the company if the assumptions made in preparing the budgets/plans are not fulfilled, whether this arises from factors the company can control (such as higher expenses or lower new business) or external factors such as investment returns.

#### *11.2.1.4 Control/operational risk, Group/contagion risk*

It is important that companies have proper systems and controls to administer their business and to report on it. As well as the normal functions, the systems and controls should ensure that the possibility of fraud is reduced to a minimum, that no one person has too much power, such as in controlling investment activity, and that there are adequate plans in place to deal with disaster scenarios. Where an insurance company is part of a group there is a particular risk that the insurance company may

enter into inappropriate transactions with other group companies to the detriment of the insurance company or that events in other group companies may adversely affect the insurance company. It is particularly important therefore that the risks resulting from membership of a group are controlled. Particular care is needed if there are off balance sheet liabilities, whether they relate to group companies or not.

#### 11.2.1.5 *Legal risk, Tax risk, Regulatory risk*

Some of these risks may be outside the control of the companies. However, it is important for companies to be aware of these risks and to monitor the likely effects on their business of particular developments. Legal risks may affect all companies, such as court decisions increasing the extent of liabilities under certain types of policies, or be internal to a company where a court judgement might interpret policy conditions in a more onerous way than the company management has allowed for. This latter risk may be particularly important where companies offer different products or policy conditions or have a different management philosophy to its peers.

#### 11.2.1.6 *Dominance Risk*

This risk can be particularly difficult to quantify. It is currently believed that dominance has been an important factor in a number of high profile corporate failures over the past few years, including HIH in Australia, and Equitable Life in the UK. It will generally be possible to get an impression during a visit of the extent to which issues are referred upwards, and what checks and balances are applied in practice. Signs to particularly note are any combining of key roles within a single individual, such as Director General and Chairman, or Director General and Actuary.

#### 11.2.2 Summary of Inspection objectives

In summary the inspection will attempt

- (a) to appraise the assets and liabilities (including off balance sheet commitments) and to analyse the adequacy of premiums and the financial outlook for the organisation;
- (b) to evaluate the technical conduct of the insurance business (e.g. actuarial methods, business plans, investment policy, reinsurance policy);
- (c) to assess the accounting and internal control systems, and to form an opinion on the corporate governance;
- (d) to detect problems that may arise from the company's organisation or its belonging to a group.
- (e) to evaluate the treatment of customers and to determine whether unlawful or improper activities are engaged in at the expense of policyholders or public interests;

However, on-site inspection should not be limited to detecting the company's problems, if any. The Insurance Commission should also understand the reasons behind them and be in a position to assess management's proposed solutions to overcome them.

On site inspections should add value to the supervisory process. As such, unless there are good reasons, the inspection should not merely try to carry out the same function as the company's actuaries, accountants or auditors. However, if the results of the inspection suggest that these professionals are not carrying out their duties satisfactorily then the Insurance Commission should follow this up as appropriate.

### **11.3 The On-Site Inspection Procedure**

It will be necessary to decide at what frequency routine on site inspections will be carried out. This should be at least once every three years. Ideally they should be at more frequent intervals but this would depend on resources being available. On-site inspections should also be more frequent and more in depth when they concern companies that are in a difficult economic or financial position or for companies that have a high risk profile. Additionally, a major change in the top management or in the objectives and business plan of the company might be a sufficient reason for a new on-site inspection. It may be that a full three yearly cycle of inspections could be supplemented by more limited visits in the intervening period, particularly where a company is thought to have problems.

In any event, there should be no constraint on the Insurance Commission discussing particular issues with company management or arranging a full or partial on site inspection outside the normal cycle whenever appropriate.

The company visit program for on-site inspections should remain indicative since new priorities might arise during the year. The length of the inspection is not predictable but in the normal course of events, given the size of the Jordanian companies and the resources available, the actual on-site inspection is likely to last anything from one day to five days depending on the business of the company, its size, and on the problems met.

#### **11.3.1 Planning for the visit**

Following the analysis of the financial and statistical information sent by the companies, the supervisor should develop a program, based upon a systematic analysis of the records of the company, for the on-site inspections which are to be carried out in the next months.

In this respect, an on-site inspection should begin with an overview of the company, including issues highlighted in any previous on site inspection visit reports, in order to properly plan and focus the fieldwork. This overview should be in the context of the overall insurance industry position in Jordan and the particular company's position in it, as well as the broader economic picture. This overview is likely to encompass, among other things, industry level statistics, the level of competition in the market, the basis for competitive advantage, barriers to entry and the threat of new products, the relative bargaining power of insurance companies relative to intermediaries and customers, the position of the investment markets and the exposure of the industry to losses that are difficult to quantify such as long tail business in general insurance or guarantees in life contracts.

While on-going monitoring can be systematic and to a certain extent standardised (analysis of the consistency of financial statements, position of the company with respect to the average of the market), on-site inspection is customised and suited to the company's particular features, and to the problems detected on site. Thus, it is difficult to determine in advance the length and exact outline of on-site inspections. Additionally, an on-site inspection can either be a full-scale inspection or a partial one, depending on circumstances.

Where the Insurance Commission undertakes a full-scale on-site inspection this should include at least the activities listed below. However, where an inspection is concentrated on a limited area of specific concern, the Insurance Commission would limit its inspection to the relevant activities.

#### 11.3.2 General points to consider

- reading
  - (a) the minutes of the meetings of the Board of Directors,
  - (b) auditor's reports, management letters and the company's responses, if any,
  - (c) actuarial reports to the Board or management
  - (d) reports on electronic data processing audits
  - (e) the minutes of meetings of the investment committee and reports on investment performance, including, for life companies, the role of the Actuary in setting investment policy
- analysis of the ownership structure and sources of capital funds;
- for life companies, an assessment of the position, role and influence of the Actuary and the resources granted to him to carry out his functions
- evaluation of the fitness and properness of the management, their culture, efficiency, strategic vision, appetite for risk, credibility and track record for meeting expectations, control and risk management capabilities, depth, breadth and succession plans, the accomplishments of key executives and their ability to acknowledge and correct their management mistakes (especially after changes in the composition of the board);
- examination of the accounting procedures in order to know whether the financial and statistical information periodically sent to the Insurance Commission is trustworthy or not, and in compliance with the regulations.

#### 11.3.3 Evaluation of the management and internal control system

It is important to examine of all the company's current internal procedures and risk control systems in order to assess the relevance of these internal controls and the company's approach to risk management. This will include:

- (a) A company's arrangements to furnish its directors with the information they need to play their part in identifying, measuring, managing and controlling risks of regulatory concern. Three factors will be the relevance, reliability and timeliness of that information. It is the responsibility of the company to decide what information

is required, when, and for whom, so that it can organise and control its activities and can comply with its regulatory obligations. The detail and extent of information required will depend on the nature, scale and complexity of the business,

- (b) The directors' statement on qualitative and quantitative standards for underwriting risks appropriate to the scale and scope of its activities and the expertise of its management, including appropriate reinsurance requirements. The systems in place for the directors or senior managers to monitor that the risks undertaken and reinsurance programs are within the standards that have been set.
- (c) A company's arrangements to maintain a clear and appropriate apportionment of significant responsibilities among its directors and senior managers in such a way that it is clear who has which of those responsibilities; and the business and affairs of the company can be adequately monitored and controlled by the directors and relevant senior managers of the company.
- (d) Whether a company's reporting lines are clear and appropriate having regard to the nature, scale and complexity of its business. These reporting lines, together with clear management responsibilities, must be communicated as appropriate within the company.
- (e) Where it is made possible and appropriate by the nature, scale and complexity of its business, whether a company has segregated the duties of individuals and departments in such a way as to reduce opportunities for financial crime or contravention of requirements and standards under the Insurance Regulatory Act. In particular, the duties of front-office and back-office staff must be segregated so as to prevent a single individual initiating, processing and controlling transactions, including investment transactions.
- (f) Whether the company has considered if it is appropriate to have a separate risk assessment function responsible for assessing the risks that the company faces and advising the directors and senior managers on them.
- (g) Whether suitable controls, systems and procedures are in place to ensure adequate and accurate information is appropriately and promptly recorded to enable a proper assessment to be made of the ultimate cost of all claims or potential claims under general insurance contracts, if appropriate
- (h) Whether appropriate and effective systems and controls are in place to allow the insurer to record and monitor its financial liability to policy holders in respect of claims arising out of general (life?) insurance contracts, if appropriate.
- (i) Whether it is appropriate for a company to delegate much of the task of monitoring the appropriateness and effectiveness of its systems and controls to an internal audit function. An internal audit function must have clear responsibilities and reporting lines to an audit committee or appropriate senior manager, be adequately resourced and staffed by competent individuals, be independent of the day-to-day activities of the company and have appropriate access to a company's records.
- (j) Whether a company plans its business appropriately so that it is able to identify, measure, manage and control risks of regulatory concern. Whether the company, depending on the nature, scale and complexity of its business, has appropriate



business plans or strategy plans documented and updated on a regular basis to take account of changes in the business environment.

- (k) Whether a company has in place appropriate arrangements, having regard to the nature, scale and complexity of its business, to ensure that it can continue to function and meet its regulatory obligations in the event of an unforeseen interruption. These arrangements must be regularly updated and tested to ensure their effectiveness.
- (l) Whether a company has taken reasonable care to make and retain adequate records of matters and dealings (including accounting records), which are the subject of requirements and standards under the regulatory system.
- (m) Whether a company's systems and controls enable it to satisfy itself of the suitability of anyone who acts for it.
- (n) Whether a company has considered whether it is appropriate to form an audit committee. An audit committee would typically examine management's process for ensuring the appropriateness and effectiveness of systems and controls, examine the arrangements made by management to ensure compliance with requirements and standards under the regulatory system, oversee the functioning of the internal audit function (if applicable) and provide an interface between management and the external auditors. It must have an appropriate number of non-executive directors and it must have formal terms of reference.

#### 11.3.4 Investment Strategy

The large funds that insurance companies build up make the adoption of an appropriate investment strategy particular critical.

The on-site visit should seek to establish whether suitable controls and management information systems are in place to enable the insurer to implement an appropriate investment strategy. Such a strategy must have due regard to the following -

- An insurer should not carry on any commercial business other than insurance business and activities directly arising from that business. Trading in financial instruments for speculative purposes would not be considered to be investment activity directly arising from the insurance business.
- Overall responsibility for the determination, implementation and monitoring of such a strategy rests with the board of directors.
- That title to the company's investments is clear and that the assets are securely held (e.g. that arrangements for the safe keeping of share certificates are appropriate).
- The requirements that its liabilities under contracts of insurance entered into by it, other than liabilities in respect of 'linked benefits', are covered by assets of appropriate safety, yield and marketability having regard to the classes of business carried on.
- Currency matching and localisation issues.

- In the case of an insurer carrying on long-term insurance business, the board must be aware of the responsibilities of the actuary and should consider seeking advice from him concerning an appropriate investment strategy.
- Appropriate procedures must be in place for assessing the credit-worthiness of counterparties to whom the insurer is significantly exposed and for setting lower internal limits where prudence dictates such a course. This applies in particular to potential exposure to reinsurers. Whilst the [Decision on the Guidelines for the Solvency Margin Instructions of 2002] and the [Reinsurance Instructions of 2002] ensure that additional capital requirements are made in respect of lower rated reinsurer, and that exposures to such reinsurers must be restricted, these do not mean that the insurance company should be entirely reliant on these **Instructions and Decisions**.
- Appropriate procedures must be in place for setting prudent limits for the insurer's aggregate exposure to certain categories of asset. Such limits must take account of the requirements concerning the suitability of assets to cover insurance liabilities. They may take account of the level of the insurer's free assets bearing in mind the possibility that such assets might in future be needed to cover insurance liabilities or the minimum solvency ratio.
- Systems must be in place to allow the insurer to monitor its aggregate exposure to different categories of asset (paying particular attention to the different kinds of instrument under which exposure can arise) or to particular counterparties relative to the limits set under the procedures described in the previous two paragraphs.
- Systems must be in place to ensure that the assets of investment-linked long-term insurance funds of the insurer are matched with the investment-linked liabilities or that if there is any excess of investment-linked liabilities over linked assets, then that an appropriate mismatching reserve is maintained.
- The investment strategy must be reflected in clear terms of reference from the insurer to its investment managers who must be qualified and competent to carry out their assigned function. The work of the managers must be monitored sufficiently closely to ensure that the insurer's strategy is being followed and that the systems mentioned above are effective. These points apply equally where an external manager is used for this purpose, where a separate legal entity within the insurance group is used (in either of which cases there must be a formal agreement between the two parties) or where the managers are internal.
- Companies must ensure that controls over derivatives, or investments having the characteristics of derivatives, and other complex investment instruments have been implemented and are adequate to ensure that risks are properly assessed, regularly reviewed in the light of changing market conditions and experience and consistent with the overall investment strategy. Any investment in derivatives should take into account the attitude of the Insurance Commission to such investments, and **at a minimum all insurance companies should have to obtain explicit permission for any such investments**.

**Comment [d43]:** This point seems a little unfair to the companies following edicts in the decisions and instructions!

**Comment [d44]:** This is advice to the commission on future regulation: no requirement currently exists to seek approval. Given that this section instructs examiners, perhaps it should be deleted.

- Resources allocated to the tasks mentioned above must be appropriate, both in quantity and quality, for ensuring that the controls are effective at all times.
- In order to satisfy themselves that investment activity is carried out in accordance with the approved strategy and that adequate controls are in place, the board of directors must receive reports at an appropriate frequency with appropriate details as to the investment activities and controls.

#### 11.3.5 Analysis of the company's activity

The ongoing activities of the company need to be examined, including:

- analysis of the major categories of business, the customers and the geographical spread thereof and any changes that have or are taking place.
- evaluation of the organisation and the management of the company.
- examination of the business plans and meeting with the management to get information about the plans for the future.
- analysis of the contracts, including whether they include any unusual features.
- analysis of the administrative and technological capabilities
- current market conditions and market share; peer group comparisons; pricing trends in major business lines.
- renewal/retention rates and trends
- distribution channels and strategy; analysis of largest new business sources
- management incentive programs

#### 11.3.6 Evaluation of the technical conduct of insurance business

Insurance is a highly technical field, and it is important that sufficient consideration is given to the following:

- analysis of the commercial policy of the company: in particular, policy conditions and commissions paid to the intermediaries.
- evaluation of the reinsurance cover and its security: in particular,
  - (a) the reinsurance cover should be appropriate to the financial means of the company and the risks it covers.
  - (b) Reinsurance should be available when needed
  - (c) The cost of purchasing reinsurance should not undermine the profitability of the business
  - (d) Exposure to collection disputes with reinsurers should not be excessive

#### 11.3.7 Analysis of the relationships with external entities

Relationships with other parties can lead to problems for any organisation, and the following need to be considered:

- analysis of the organisational charts, the group structures and the intra-group links.
- analysis of the relationships with branches abroad and the intra-group transactions.
- analysis of agreements with external service providers.
- identification of any financial problems originating from any entity in the group to which the company belongs.

### 11.3.3 Evaluation of the company's financial strength

Regulation is largely in place to try to ensure that insurance companies remain solvent, so that an examination of the company's financial strength is a key part of any inspection

- analysis of the settlement of claims and the calculation of the technical provisions according to current regulations; adequacy of reserves.
- underwriting expertise in each class of business and using an appropriate style of underwriting according to the nature of the risks.
- exposure to large losses such as property catastrophes
- the balance between premium growth and underwriting discipline i.e. buying market share
- controls over third party underwriters
- claims management expertise
- expense efficiencies
- analysis of the adequacy of premiums including target profitability in the context of the balance of its operations.
- analysis of the investment policy (including derivatives policy), the assets held to cover the technical provisions. Intangibles and off balance sheet assets and liabilities
- verification of the values placed on the company's assets.
- analysis of the litigation and off balance sheet commitments.
- recent profitability and the reasons for it.
- analysis of the forecast balance sheets and profit & loss accounts of the next two or three years, on the basis of the most recent results and the management plans.
- utilisation of reinsurance.
- any dividend payment constraints e.g. the parent/market expects a minimum dividend each year of some specified amount

### 11.3.9 Consumer Protection

The Insurance Commission may include the following points in the on-site inspection:

- (a) review of the information given to customers and checking of its sufficiency and adequacy;
- (b) review of the time for settlement of claims, the number and nature of any cases of litigation and the levels of service provided to the policyholders;
- (c) assessment of the compliance with any applicable consumer regulations.

#### 11.3.10 Assessment and reporting

During, or at least at the end of this inspection, the Insurance Commission should discuss its findings with the insurance company and should take into account as appropriate any relevant comments made by its management. The Insurance Commission should prepare a written report on its findings and if appropriate write to the company setting out its areas of concern and any action it expects the company to take as a result.

The Insurance Commission should follow up to ensure corrective action, when identified, has been acted upon.

### **11.4 Organisation Of The On-Site Inspection Process**

The Insurance Commission should organise the process of on-site inspections in order to maximise their efficiency. In doing so, it should consider, among other matters, the allocation of supervisory tasks between Insurance Commission staff and whether it is appropriate to outsource certain parts of the inspection. It is important that those people carrying out the inspection have the necessary skills, knowledge and training for their particular tasks. In particular, it is important that the Insurance Commission has credibility with the senior management of insurance companies and is able to discuss issues with them based on relevant skills, knowledge and experience.

On-site inspection will presumably be carried out by the same staff as are involved in the on-going monitoring of the company. This will ensure co-ordination and sharing of information arising from the regular offsite monitoring and on-site inspection. It appears to be an efficient way of regulating companies over time. However, it requires staff dealing with all aspects of insurance supervision (e.g. accounting, actuarial methods, finance, data processing) and all types of insurance (e.g. health, vehicle, liability) and this may impose practical constraints.

The alternative would be for the Insurance Commission to employ specialists in some tasks or in some types of insurance who will take part in the on-site inspection of a large number of companies. This type of organisation appears to be flexible and efficient to deal with market problems. However, good cooperation and exchange of information is needed between officers in charge of monitoring and those in charge of on-site inspection. Accordingly, results of analyses must be documented and accessible to both groups.

Whatever the internal organisation set up by the Insurance Commission, the Insurance Commission may get assistance from external auditors or actuaries to whom they delegate, in part or completely, on-site inspections. Using these professionals may provide the Insurance Commission with flexibility and augment their skills.

However, since the Insurance Commission remains responsible for supervision, before using external auditors or actuaries, it should consider:

- (a) whether adequate controls over their competence exist and the need to monitor their performance (for instance, through reviewing their working papers);
- (b) their independence towards the company (in particular whether the company receives any fees from the insurance company in respect of work carried out for it) and the consideration they give to the protection of the policy holders' interests.

Should such a delegation be set up, the supervisor should have the ability to take legal action against these auditors and actuaries, if necessary.

### **11.5 Use of the On-Site Company Inspection Checklist**

The On-site Company checklist is a long document. Although the detailed check list provides spaces for ticks to indicate whether the answer to a particular question is yes or no, the checklists are not designed as purely a tick box exercise. It will be necessary for those carrying out the inspection to have appropriate skills, knowledge and experience to understand the importance of particular questions and the company's responses to them. It is not sufficient to just tick an answer – the onsite inspection team must weigh up the answer and decide what if any further action or comment is necessary in response to the position disclosed.

## **12 TRANSFERS OF BUSINESS**

- **Statutory provisions**

Transfers of insurance business are covered by Article (53) of the Insurance Regulatory Act of 1999, which states:

**Article (53):**

- A-The Company may transfer the insurance policies it issued, including the rights and obligations related to any of the classes of insurance transacted thereby, to a Company or several companies transacting the same class.
- B-1- The request for the transfer shall be submitted to the Director General with the policies and documents related to the transfer agreement attached thereto, for preliminary approval
- 2-The Director General shall publish the request for the transfer, in two daily local newspapers, to be published twice consecutively, the cost for which shall be borne by the applicant, provided that there is a reference to the right of the policyholders and beneficiaries, or any interested party to submit thereto an objection to such a transfer within a period of fifteen days from the date the request for the transfer was first published expressing the subject of the objection and the reasons relied upon.
- C-The Director General shall finalize the legal procedures to transfer the insurance policies, including the rights and obligations therein, after all the objections submitted thereto are determined.

Article (53) makes transfers of any **insurance business** between two Jordanian companies subject to approval by the Director General. Where such a company (“the

transferor”) proposes to transfer the whole or part of its business to another such company (“the transferee”), a request for the transfer must be submitted to the Director General.

It is recommended best practice that the Commission request (in respect of any life insurance business).

- a report by an independent actuary (i.e. an actuary other than the Actuary or internal actuary of either the transferor or transferee) relating to the terms of the proposed transfer, in which the actuary expresses clearly and adequately his opinion with respect to the likely consequences of the transfer for the existing policyholders of both the transferor and transferee;
- a certification by the actuary of the transferee that the transferee will cover its minimum solvency ratio after the proposed transfer is taken into account.

It may be useful also to obtain these reports and certificates in respect of any general insurance business transfers.

The Director General should not decide whether or not to accept the transfer unless he is satisfied that:

- notice of its submission has been published in two daily local newspapers twice consecutively;
- unless the Director General directs otherwise, the terms of the proposed transfer and the report by the independent actuary have been sent to all policyholders of both the transferor and transferee, and to any other person who claims rights to an insurance policy and has submitted his claim in writing to the transferor;
- the terms of the proposed transfer have been open for inspection at the offices of the transferor and transferee for a period of at least 15 days since the notice of submission of the request for the transfer was first published.

In deciding on the request to transfer, the Director General should hear the Board of directors of the transferor and transferee, any person who has submitted an objection to the proposed transfer, and any other person whom he judges purposeful to hear. The Director General should sanction the proposed transfer if and only if:

- it is satisfied with its terms in the light of these hearings;
- it is satisfied that that the transferee holds, or before the issue of the order will hold, a licence issued to carry on insurance business of the class or classes of business to be transferred to it;
- it is not the case that policyholders who represent at least 10% of the total insured amounts of the transferor oppose the proposed transfer.

The provisions of Article (53) summarised above apply equally to the transfer of insurance business:

- from a Jordan insurance company to a foreign insurance undertaking carrying on insurance business in Jordan;

- from a foreign insurance undertaking carrying on insurance business in Jordan to another foreign insurance undertaking irrespective of whether the latter carries on insurance business in Jordan or not; and
- from a foreign insurance undertaking carrying on insurance business in Jordan to a Jordan insurance company;

subject, in the former two cases only, to the additional requirement that the Director General must be provided with the written consent to the proposed transfer of the insurance regulator of the transferee.

**Comment [d45]:** This is not in Article 53. Perhaps it should be characterized as a best practice?

- **Transfers of life business**

- Objective of the Commission

The Commission's main objective is to ensure as far as possible that the terms of the transfer are fair to all policyholders, and that they have an adequate opportunity to learn about these terms and assess sufficient information to form a view on the transfer's merits.

#### 12.2.2. Recommended best practice

The Commission should copy to its **legal advisors** all main correspondence relating to life business transfers. However, their involvement need not necessarily be a close one, unless there is some dispute about the terms of transfer.

The role of independent actuarial advisors in advising the Commission in transfer cases involving life business may be paramount. These advisors should therefore be consulted on every document sent to the Commission, and should be invited to participate (by speaker phone and where possible in person) in all meetings held with the companies.

Companies should be aware of the Commission's role in transfers of life business and it is therefore likely that they will seek an early meeting with it to discuss its views. This is to be encouraged, as is the early submission of draft documents relating to the transfer, including the transfer agreement itself, the report by the independent actuary (if one is appointed) and the letters to policyholders giving notice of the transfer. The Commission should engage in active discussion with the companies concerned and the independent actuary, with a view to identifying, discussing and seeking amendments to any terms of the transfer that it finds unacceptable.

The Director General may consider it important that all policyholders of the transferor and transferee be informed in writing of the terms of the transfer. Given this, some companies may argue that the policyholders of the **transferor** should not be informed of the transfer. Typically, a company will advance the argument that:

- the independent actuary has already "cleared" the scheme as not adversely affecting policyholders' interests;
- the transfer is no more than an internal reorganisation; or
- individual notification is costly.



However, it is recommended best practice that the Commission should **always reject** such arguments. If the policyholders of the transferor are not individually informed, they may lose the opportunity to make known to the Commission that they believe they are being adversely affected. To hold this line, the Commission should be able to argue successfully that it is not fully in a position to know whether individual policyholders' interests will be affected, and that it should not therefore agree to rights of policyholders being dispensed with.

A somewhat more relaxed attitude might be adopted with regard to information to be provided to policyholders of the **transferee**. If that company is strong, the volume of business it is receiving is relatively small and, moreover, the independent actuary has expressed the view that there will be no adverse effect on its policyholders, then the Commission might be content to allow the transferee not to notify its policyholders individually. However, where such a direction is sought, it is recommended best practice that the Commission should often ensure that there is, in addition to the minimum publicity in the press required by Article (53), substantially wider publicity.

Naturally each case must be considered on its merits. The transferor and transferee should always be asked what their proposals are for informing their policyholders, and where there is doubt on the matter it is safer for the Commission to err on the side of maximum provision of information.

The Commission should give consideration as to whether the transferor's licence to carry on insurance business should be withdrawn.

Care should be taken not to rely excessively on precedent. However, there are certain similarities between categories of cases and key decisions e.g. in agreeing a company's proposals not to notify policyholders of the terms of a transfer, which should be noted in the **precedents register**. Brief details of individual cases should also be noted in a "general policy" file, so that there is a record of each company whose portfolio of life business has been transferred, either wholly or in part.

The transferee may sometimes provide **undertakings** as part of the transfer. Care should be taken to record what these are, and how they should be monitored. Such undertakings may still be relevant 10 years or more after the business has been transferred.

- Report by the independent actuary

There is no legal requirement for the Insurance commission to require that a report is produced by an independent actuary. If the life business of the transferor is small and consists of risk business only (e.g. Group Life and term assurances) then there may be limited value in requiring such a report.

If, however, the life business contains significant long term investment-linked or with-profits insurances then the report by the independent actuary is of critical importance.

The **independent actuary** must be an actuary other than the Actuary of either the transferor or transferee. In addition, it is recommended best practice that the Commission should require the following:

- before accepting an appointment as the independent actuary in any particular case, an actuary must consider whether he or she has relevant practical knowledge and

experience. Such experience would necessarily include familiarity with the role and responsibilities of an Actuary and with the types of life business transacted by the companies concerned;

- the actuary must also disclose to all the parties involved any direct or indirect interest he may have or have had in any of them. Clearly, he cannot act if such interest would, in the opinion of any party or its legal advisers, be likely to prejudice their status in the eyes of the Insurance Commission;
- the transferor would normally appoint the independent actuary. However, the purpose of the appointment is to secure an independent opinion for the Director General on the likely effects of the transfer on the life policyholders of the companies concerned, and it would therefore be improper for the independent actuary to:
  - take instructions from any of the parties on what should be included in or excluded from the report;
  - be denied access by any of the parties to persons (s)he may wish to interview, or to information, reports and documents which (s)he may reasonably consider material to the formulation of an opinion on the likely effects of the transfer on the life policyholders of the companies concerned;

and an actuary should ensure that this is understood by the parties concerned before accepting an appointment;

- if, for any reason other than the abandonment of the transfer, the independent actuary's appointment is revoked or they resign prior to their report being submitted to the Commission or being circulated to life policyholders, (s)he should consider whether the circumstances are such that they should make them known to the Commission. Any actuary offered an appointment as an independent actuary should enquire if the appointment has previously been accepted and subsequently vacated by another actuary; if so, an actuary should take all reasonable steps to establish the circumstances in which the revocation of the previous actuary's appointment or their resignation took place.

Given that the court is unlikely to sanction the transfer if the independent actuary indicates serious dissatisfaction with its terms, it is in the interest of all the parties that, once an actuary has been appointed, the independent actuary is informed of the draft terms and provisions of the proposed transfer at the various stages of its development. The Commission should therefore look to the independent actuary to actively seek such information and be prepared to indicate with impartiality any terms or provisions which by their inclusion in, or omission from, the transfer as drafted, would be likely to cause them to express reservations about the transfer in their report.

The Director General is entitled to be heard by the court when a petition is being considered. It is therefore for the independent actuary to contact the Commission at an early stage, with the knowledge of the petitioner, to establish whether there are any matters pertaining to the transfer which the Commission wishes to draw to their attention. This line of communication should be maintained until the transfer is presented to the court.

The amount of investigative work that the independent actuary needs to do depends on the circumstances of the case. It is reasonable for the independent actuary to expect the Actuary of the transferor to provide such valuations of the assets and liabilities as (s)he may require, and to disclose information on such matters as how bonus rates have been determined in recent years in respect of any with-profit business. If the transferee already has life business of its own, similar information from the Actuary of that company may also be necessary. In complex cases, it may be desirable for the request to transfer to be accompanied by a report from any Actuary concerned. There may also be private actuarial reports to one or more of the parties, production of which would assist the independent actuary in appraising the terms of the transfer. However, it is essential for the independent actuary to form an independent judgment on the quality of the information supplied, the reasonableness of the work of other actuaries, and, therefore, the extent of any investigative or verification work he needs to do.

The independent actuary might be asked to attend a meeting with the policyholders organised by the management of one of the companies. If so, he should consider carefully whether to do so would give the impression that they were not entirely independent. If they decide to attend the meeting, their position should be properly explained, and nothing that he does or says at the meeting should undermine the perception of independence.

In the case of a transfer involving a **composite** company, the independent actuary needs to understand the relevance of the general insurance business to the security of the life policyholders, and he may need to seek independent specialist advice in this regard.

Special considerations may also be called for where the transfer forms part of a chain of events including restructure, reinsurance or changes in ownership, and the independent actuary should seek explanations regarding corporate plans to the extent necessary for the whole picture to be clear.

If the Actuary of either of the companies involved has held that position only for a relatively short period of time, it might be appropriate for the independent actuary to seek information from the previous Actuary.

Other **documents** that the Commission should look to the independent actuary to normally wish to examine in relation to each of the companies involved in the transfer include:

- its memorandum and articles of association and, if the company is currently trading, its latest annual report and accounts and returns;
- the latest report submitted by its Actuary to the directors on bonus recommendations, together with any recent financial condition report (FCR);
- any reports, actuarial or otherwise, dealing specifically with Policyholders Reasonable Expectations;
- the bases used for own-charge illustrations;
- sample quotations and policy documents which state or illustrate how policies will participate in profits, qualify for discretionary benefits, or be subject to future variations in charges;

- any reports dealing with investment policy of the life assets;
- any reports evaluating alternative transfers;
- any other relevant documents associated with the transfer.

In addition, the independent actuary should ask about the operational plans of any company which, after the effective date of the transfer, will have policyholders who fall to be considered in their report.

The independent actuary's **report** should express clearly and adequately their opinion with respect to the likely consequences of the transfer for the existing policyholders of both the transferor and transferee. In addition, it is recommended best practice that the Commission should require the following:

- the independent actuary should bear in mind in preparing their report that policyholders and members may rely upon it when considering how to cast their vote in any meeting called to approve the terms of the transfer, and that any member of the public may rely upon it when considering whether or not to make representations to the Director General about the likely adverse effect of the transfer on them;
- the independent actuary needs to consider, and report as appropriate on, the likely effects of the transfer on:
  - all transferring life policyholders;
  - any life policyholders of the transferor whose policies will remain with that company; and
  - any life policyholders of the transferee;
- whilst not directly concerned with the effect of the transfer on those who become policyholders on or after the date when, subject to the approval of the court, it will become effective, the independent actuary also needs to consider whether the development plans of either of the companies involved may adversely affect policyholders with whom he is concerned;
- the term "independent actuary" might be interpreted by members of the public as indicating that he was advising on the relative merits of one transfer against other possible arrangements, but this is not specifically required. Consistent with the nature of the legal requirements, the report must include a comparison of the likely effects on the life policyholders of the relevant companies if the transfer being presented to the court is or is not implemented. In addition, the report should state clearly whether or not alternative transfers were considered;
- the contents of the report should reflect the circumstances of each case; however, the following are some of the matters which the Commission should normally look to the independent actuary to cover in it:
  - the name of the party which has appointed the independent actuary, and a statement of who is bearing the costs of that appointment;
  - a statement of the independent actuary's professional qualification (as appropriate);

- whether or not the independent actuary has a direct or indirect interest in any of the parties which might be thought to influence their independence; if the independent actuary has such an interest, it should be disclosed;
- the scope of the report, in the sense of the previous bullet;
- the purpose of the transfer;
- a summary of the terms of the transfer in so far as they are relevant to the contents of the report;
- what documents and reports the independent actuary has considered in relation to each of the companies involved in the transfer and whether there was any additional information which was requested but not provided;
- the cost and tax consequences of the transfer in so far as these will affect policyholders' funds;
- the effect of the transfer on the security of policyholders' contractual benefits;
- the effect of the transfer on the nature and value of any rights of policyholders to participate in profits. In particular, if any such rights will be diluted by the transfer, how any compensation being offered to those policyholders as a group (which might take the form of an injection of funds, an allocation of shares, or cash payments) compares with the value of that dilution, and whether the extent and method of its proposed division is equitable as between different classes and generations of policyholders;
- the likely effect of the transfer on the approach used to determine the amounts of non-guaranteed benefits such as reversionary (or similar bonus which is added periodically over the term of the contract) and terminal bonuses and surrender values, and the levels of discretionary charges, for example under linked policies; and what safeguards are provided by the transfer against a subsequent change of approach that could act to the detriment of existing policyholders of either company and is not due to external circumstances beyond its control;
- the likely effects of the transfer on matters such as investment management, new business strategy, administration, expense levels and valuation bases, in so far as they may affect the ability of the companies to meet throughout the lifetime of existing policies the reasonable expectations of the holders of those policies;
- those matters, if any, that the independent actuary has not taken into account or evaluated, which might nevertheless be relevant to policyholders' consideration of the transfer;
- the independent actuary's overall assessment of the likely effects of the transfer on the reasonable expectations of life policyholders; whether (s)he is satisfied that, for each of the companies concerned, the transfer is equitable to all classes and generations of its policyholders; and whether for each relevant company the transfer places obligations on the directors, or provides for future

certification by its Appointed Actuary, sufficient in their opinion for the protection of those expectations;

- where the independent actuary expresses an opinion in the report, he should outline the reasons for it.

- **Transfers of general business**

- Objective of the Commission

The duty to approve or reject the proposed transfer rests with the Director General (true for life as well? It's not stated at the beginning of the section on life insurance transfers). The Commission's main objective is to enable companies to effect transfers of general business whilst at the same time protecting policyholders against the risk that their legitimate claims may not be met.

- Recommended best practice

The Commission might want to consider whether there is value in appointing an independent actuarial advisor to report on the transaction.

The Commission should copy to its **legal advisors** all main correspondence relating to general business transfers. However, their involvement need not necessarily be a close one, unless points of difficulty arise or there is a difference of opinion between the Commission and the parties to the transfer as to the legality of the various documents required, or where information is at hand which suggests that there may be sufficient grounds for the Director General to refuse the transfer. Legal advice should always be sought in such circumstances.

Due to its gravity, only the Director General should take any decision as to whether the Commission should approve the transfer.

Companies should be aware of the Commission's role in transfers of general business and it is therefore likely that they will contact it with details of the proposed transfer. It is important for the Commission to understand the reason for the transfer, and it may be necessary to obtain further information from one or both of the companies concerned if the details provided are sketchy or if the rationale for the transfer does not appear to make sense.

The application **could** be indicative of the transferor getting into financial difficulties and trying to reduce its liabilities by means of a transfer. Because of the possibility of such a company subsequently going into liquidation, the Commission should consider the implications for a transfer of such proceedings, and in particular the ability of the liquidator to apply to the court for its reversal were transactions at an undervalue or preferences to be identified.

The Commission should be satisfied that the transferee is, or immediately after approval of the transfer will be, authorised for the class or classes of general business due to be transferred to it, and that both the transferor and transferee are covering their minimum solvency ratio before the transfer. It is important that these checks are carried out at the earliest possible stage so as to avoid the transferor making an unnecessary application.

The Commission should encourage the transferor to submit drafts of the transfer application and supporting information as soon as possible, so that any points of uncertainty can be clarified before a formal application is made. The transferor may request a meeting with the Commission to discuss the proposed transfer in greater detail before the draft application is submitted.

The draft application should include the following documents:

- the press notice required under section 53 of the Law;
- a statement of particulars of the proposed transfer;
- statements showing the available assets and minimum solvency ratio of both the transferor and transferee both before and after the proposed transfer;
- a statement showing the number of policies to be transferred, subdivided by class of business, and their value;
- details of any reinsurance arrangements in respect of the business concerned that will pass to the transferee;

Upon receipt of these documents, the Commission should check that all the required information has been provided. If the draft covering letter from the transferor does not include a formal request for the Director General's approval of the transfer, the transferor should be informed that the covering letter enclosing the final version of the application must do so.

The Commission should then check that the transferee (and where relevant the transferor) will still be covering its minimum solvency ratio in the event of the transfer going ahead.

Whilst the transferor and transferee must expect to incur some additional expenditure as part of the transfer process, the Commission should, in exercising its discretion on notification requirements, have regard to the need not to impose costly requirements on the companies in excess of those necessary for the protection of policyholders. In cases of doubt, however, it is in the best interests of policyholders for the Commission to err on the side of caution by requiring more rather than less disclosure.

The Commission should then write to the transferor commenting on the draft application and suggesting amendments where appropriate, and advising on its position in respect of any request for the exercise of discretion as regards notification. The transferor should be invited to submit a formal application, or if necessary to attend a meeting to discuss the draft application.

Provided the above procedures have been followed, all the Commission should need to do when the formal application is received is to compare this with the "agreed" draft application. As long as there are no material discrepancies, a letter can be sent to the transferor formally accepting receipt of the application and documentation. Care needs to be taken not to say anything in this letter that implies that the Director General will determine the application favourably, or that consideration of the application is a mere formality. The letter should also give the Commission's formal decision on the issue of a direction as regards notification, and any such direction should be issued at this stage.

Before determining the application, the Director General must ensure that proper consideration has been given to any representations received under Article (53) of the Act. Such representations are likely to be relatively rare but, where they are made, should be considered as soon as possible after receipt. They will usually be made by means of a letter to the Director General, which should be acknowledged immediately. The letter of acknowledgement should confirm that the application will not be determined until the representation, and all others, have been considered, and remind the addressee that (s)he will receive a copy of the Director General's decision relating to the transfer in due course.

It is not possible to frame advice as to the type of representations that would result in the application being refused. However, in general terms, the Director General should not approve an application if there is evidence to suggest that the policyholders would be at a disadvantage compared with their position when they were insured with the transferor. If it appears that there is information which might lead to refusal of the application, and that there may be scope for the applicants to appeal through a legal process or directly to Ministers, then the Commission's legal advisors should be consulted without delay. An application should not be refused unless this is in accordance with legal advice given, as it may be possible to defer determination of the application until such time as concerns surrounding it can be allayed. In this regard, it should be noted that there is no time limit within which the Director General needs to determine the application set under the Act.

In the case of representations taking the form of a "customer service" complaint from a policyholder of the transferor, in considering whether action needs to be taken, the Commission should only regard the complaint as valid if the policyholder is able to provide evidence that their interests would be **more** adversely affected if the transfer were to go ahead. For example, it would not be sufficient merely to show that the transferor was slow to pay claims; the policyholder would also need to demonstrate that the transferee would be slower.

Once the Director General has reached a decision on the application, the necessary arrangements should be made for this to be published and sent to the transferor, transferee and, if considered appropriate, to any person making written representations.

Care should be taken not to rely excessively on precedent. However, there are certain similarities between categories of cases and key decisions: for example, whether to give a direction modifying the usual notification requirements to policyholders, and these should be noted in the **precedents register**. Brief details of individual cases should also be noted in a "general policy" file, so that there is a record of each company whose portfolio of general business has been transferred, either wholly or in part.



## 13 CONDUCT OF BUSINESS

### 13.1 Statutory provisions

The authority and functions of the Director General set out in Articles (54) and (55) of the Act extend to the supervision of the activities of persons carrying on intermediation business:

#### **Article (54)**

A- The provisions related to the insurance Agents transactions and liabilities attached thereto, shall be determined by Instructions to be issued by the Board for this purpose.

B- No person shall be permitted to conduct the business of an Insurance Agent before providing the Director General with an agreement concluded with a Company stipulating his appointment solely by that Company; and shall not be permitted to become an Agent for more than one Company, subject to the provisions of Article (31) of this Act shall apply.

#### **Article (55)**

No person shall be permitted to function as an insurance Broker or Reinsurance Broker before obtaining a license from the Commission, in accordance with the conditions determined by the Board by Instructions to be issued for this purpose, which shall include the terms determining his liabilities and regulating his business; subject to the provisions of Article (31) of this Act shall apply.

The remainder of this section covers what is regarded as Best Practice

### 13.2 **Guiding principles**

The overall approach adopted by the Commission in relation to conduct of business issues should be based on its regulatory objectives described in section 1.2. The following subsections suggest the characteristics of an insurance market that is working well in the conduct of business arena, and what achieving these implies by way of regulatory response.

#### 13.2.1 Desirable market characteristics

1. Consumers should have confidence in the insurance industry, to allow them to safeguard themselves and others from adverse events and to save. They should be able to expect high standards from insurance companies.
2. Consumers should have access to competitively priced, and well designed, insurance products, including consumers of moderate means.
3. The products should be understood pre, at and post sale. They should be sold responsibly, and be appropriate to the needs of the buyer. They should meet the buyer's ?? Policyholders Reasonable Expectations, as evidenced at point of sale.
4. Consumers should take responsibility for their own actions. However, they should receive clear and accessible literature relating to products, on which to base their buying decision.

**Comment [d46]:** This phrase comes from rules not yet adopted.

5. For life business that involves a significant savings element, consumers should receive sound advice, based on their needs, and on a known basis, with an understanding of the cost of advice and the capacity in which the advisor is operating. The advisors should have an adequate understanding of the products they sell to assess their suitability to these needs.
6. For life business, consumers should understand the charges under the products. These charges should be both fair and reasonable.
7. Consumers should be provided with information to monitor the performance of long term products to check that these still meet their needs. They should be able to switch their investment if necessary without excessive cost.
8. Consumers should be able to expect efficient handling of claims.
9. Consumers should be able to expect to receive information from the insurance regulator, when appropriate.

#### 13.2.2 Regulatory response

To help achieve the ideal described in section 13.2.1, it is recommended best practice for the insurance regulator to:

- require written explanation of risk and other factors relevant to the buying decision for life business with a significant investment element to it; and that advisors understand these;
- press for fair and balanced marketing, without reliance on small print;
- require high levels of disclosure, particularly with regard to commission levels on life business at point of sale, and to the exercise of discretion and investment policy post sale;
- encourage consumers to report unsuitable or unbalanced adverts and promotions;
- welcome competition, whilst remaining mindful of the (prudential issue of the) impact squeezed margins might ultimately have on the level of capital risk borne by insurance companies;
- promote customer education initiatives;
- be prepared to exercise such powers as it has under unfair contract terms legislation, if any exists;
- consider preparing comparative tables of insurance companies' performance of its own;
- communicate with consumers when appropriate, and in plain language;
- consider operating an appropriately differentiated regulatory regime to uphold proportionality, according to the type of product involved;
- enforce the statutory requirements it chooses to impose fairly, consistently and transparently;

- encourage intermediaries to establish their own code of conduct, going beyond and complementing the statutory requirements; and to join the World Federation of Insurance Intermediaries (WFII);
- put in place mechanisms to resolve and settle disputes in a timely fashion, and to provide adequate and effective redress for consumers who suffer financial loss as a result of mal-practice of intermediaries or insurance companies.

The level of regulation should be sufficiently high that poor practice is not permitted to persist and mis-selling scandals are avoided – both of which would undermine consumer confidence – but not so high as to impose unreasonable costs on the insurance industry or create undue alienation between it and the regulator – as this too would undermine consumer confidence. It should be activity based, impacting equally on all those involved in insurance mediation, so as to create a competitive and level playing field between all forms of insurance distribution. Any changes in the requirements placed on intermediaries should be promulgated with consultation, full documentation and accessibility for all market participants.

## **14 MISCELLANEOUS**

### **14.1 Insurance business only**

There is no requirement under the law for insurance companies writing business in Jordan not to undertake any other type of business. It is recommended best practice that the Insurance Commission discourage this practice though, and prohibit any new insurance companies in Jordan from writing non-insurance business.

The underlying purpose of this requirement is policyholder protection. There is a risk that if an insurance company is carrying on any activities other than insurance, those other activities might, to a greater or lesser extent, jeopardise its ability to meet its obligations to policyholders. In other words, insurance funds should not be being used for non-insurance purposes.

One circumstance in which it is important to have close regard to is that of a group containing both insurance and non-insurance companies. In such cases, the Commission should try to adhere firmly to the line that the insurance companies in the group should restrict their activities to insurance.

What does and does not constitute insurance is not always straightforward. The Commission will need to form its view, so that it can decide its regulatory response, implying the need for it to obtain legal advice in cases of doubt. It is also recommended best practice for the Commission to seek advice from independent actuarial advisors in such cases, particularly where these relate to life insurance business.

The International Actuarial Association has recently (September 2004) issued a draft document (21 pages) seeking to defined exactly what is, and isn't an insurance contract. In the event that this is accepted internationally, it may become best practice to use the IAA definition.

