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# IAIS Insurance Core Curriculum

## ICP 6: Licensing

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# Agenda

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- Introduction and issues
  - Scope of licensing
  - Licensing criteria
  - Licensing processes
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A quick pass to see what we will concentrate on today

# **PRE-TEST**

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# The most important reason for licensing insurers is ...

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Option	Answer
A	To generate license fee revenue
B	To help ensure only insurers able to meet obligations are able to operate
C	To protect established insurers from new competitors
D	To keep insurers from carrying on banking business

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An insurer may be able to operate outside its home jurisdiction in various ways except

...

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Option	Answer
A	Purchasing shares in a foreign mutual company
B	Establishing a branch
C	Forming a stock company subsidiary
D	Providing cross border services

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A composite insurer is one that ...

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Option	Answer
A	Insures both property and liability risks under the same policies
B	Was formed through the merger of two or more companies
C	Is partly owned by the government
D	Insurers both life and non life risks

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It may be acceptable for an insurer to conduct insurance business without a license if ...

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Option	Answer
A	The supervisory authority has a backlog of license applications
B	The insurer is a small fraternal organisation operating in a limited geographic area
C	The insurer is part of a very large, highly rated international group
D	The significant owner of the insurer is a former insurance supervisor

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Licensing criteria should be clear,  
objective, and public in order to ...

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Option	Answer
A	Make it easier for the licensing authority to process applications
B	Help insurers to understand what is required to enter the market
C	Make it more difficult for undesirable insurers to enter the market
D	Accomplish all the above

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If a foreign insurer applies for a license, the licensing authority should contact the home supervisor ...

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Option	Answer
A	Unless the insurer will be setting up a subsidiary
B	Only if it needs more information on the financial situation of the insurer
C	To obtain input on the suitability of key functionaries and significant owners
D	Only if a memorandum of understanding is in place to govern such contact

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When evaluating the business plan of an applicant, the licensing authority should consider that ...

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Option	Answer
A	Although the applicant's plan may seem reasonable, prudence dictates that the impact of potentially adverse developments be assessed
B	The applicant knows its business best, so its assumptions should usually be accepted without question
C	An applicant with a financially strong owner can always obtain more capital, whenever it may be needed
D	Business plans can change from year to year, so the proposed business plan is probably of limited value

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In some jurisdictions, parties other than the insurance supervisor play a role in the licensing process. This situation ...

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Option	Answer
A	Is inconsistent with the approach required by ICP 6
B	Can provide an appropriate control on supervisory power, as long as the other parties form their views without being influenced by those of the supervisor
C	Can provide for consideration of a range of views in arriving at the important licensing decision, but the views of the supervisory authority should normally prevail
D	Can be an excellent way to advance the government's market development goals without subjecting existing insurers to excessive loss of market share

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An insurer that has been a consistently profitable underwriter of motor vehicle and property insurance applies to extend its license to cover marine and aviation insurance. The most appropriate response may be to ...

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Option	Answer
A	Reject the application, since the insurer has no track record in marine and aviation insurance
B	Grant the license but restrict the maximum per-event risk that the insurer may retain within the marine and aviation portfolio
C	Grant the license but restrict its term to a period of six months
D	Grant the license without restriction, since the insurer has adequately demonstrated its capabilities already

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Once a license has been issued to a new insurer, the supervisory authority should monitor its progress ...

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Option	Answer
A	After two years have passed, to give the insurer time to get its systems and procedures fully in place
B	In accordance with the supervisory processes generally applied to all insurers
C	Frequently, to ensure that the insurer is operating in accordance with its business plan and supervisory requirements
D	Continuously, to facilitate ongoing supervisory advice to management on strategic and operational

issues

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The text can be found in appendix 1 on page 37

## **WHAT THE ICP SAYS**

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## Key issues in ICP 6

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- Insurance activity should be defined
  - Nobody should do it without a license
  - Licensing requirements should cover a range of issues
  - Decision making criteria should be clear, objective and public
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# THE SCOPE OF LICENSING

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# Simple to say, harder to do

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- Simple:
    - “an insurer must be licensed before it can operate within a jurisdiction”
  - Difficult:
    - What is insurance and what is not insurance?
    - What types of legal entity should be permitted?
    - How much freedom should be provided to licensed insurers (full scope or limited licenses)?
    - What does “operate in a jurisdiction” mean?
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# What is insurance?

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- If insurers are “entities that underwrite insurance” then a definition of “insurance” is needed.
  - International definitions have proven difficult to establish
    - Practical similarities and overlap with other financial services;
    - Commercial transactions
    - Role of local business rules
    - Role of social security benefit structures
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- As a result
    - Usually left to local laws;
    - Leads to inconsistencies across borders
  - Policy issues: When developing a definition, consider the implications for
    - Provision of services in the market
    - Potentially encouraging or discouraging market entrants
    - Advantages of consistency across markets in regions
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# What types of entities?

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- Locally incorporated companies
    - Locally owned
    - Foreign owned
  - Entities incorporated outside the jurisdiction
    - Branches in the local jurisdiction operating as separate units but not a separate legal entity
    - Cross-border services basis
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- Entities not incorporated as normal companies
    - Mutual insurers
    - Mutual Benefit Organisations
    - Cooperatives
    - Self Help groups and associations
    - Insurance pools
    - Captive insurers
    - Fraternal benefit societies
    - State-owned insurers
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## Branches

- Why might insurers prefer branches?
    - Lower costs to establish
      - Especially relevant if lower volumes expected
    - Can leverage
      - For example, capital, staff, credit rating
    - Can facilitate market exit if expectations are not met
  - Protecting the policyholders (possible rules)
    - Local assets to cover local liabilities, perhaps with margin
    - Localisation supported by deposits, trusts, etc.
    - Increasingly difficult in a globalised financial world
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# Scope of Licenses

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- Composites
    - See essential criteria (g) “An insurer licensed to underwrite life insurance business must not also be licensed to underwrite non-life insurance business, and vice versa, **unless** the supervisory authority is satisfied that the insurer has **satisfactory processes requiring that risks be handled separately** on both a **going concern** and a **winding-up** basis.”
    - Risks require careful management. Life and non life risks are fundamentally different to assess, manage, underwrite, etc.
    - Trend toward not allowing composites although ICPs do not require it.
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- Limited classes versus full scope
    - Sometimes special class cases
      - Reinsurers versus direct insurers
      - Credit / Mortgage guarantee insurers
    - Sometimes licenses are issued by class according to the law
      - To write additional classes, existing insurers would need to apply to have license modified
      - Can ensure technical skills and financial capacity are available when insurers want to adventure into another class.
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- Captives
    - The client is the owner
    - May be established in a different jurisdiction to owner's operations for tax or business reasons
      - So insurers that do not write local risks are “offshore” insurers
    - May have lighter rules or requirements due to absence of dealing with general public, especially local general public
    - If licensing captives, need to understand market developments
      - For example, protected cell companies, rent a captive
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# What does “operate in the jurisdiction” mean?

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- Cross border services
    - When permitted, usually require licensing or registration
    - Some country groups have formal standing agreement and procedure
      - Define division of responsibilities
        - Home supervisor: Prudential Oversight
        - Host supervisor: Market and Consumer Issues
  - May permit consumers to go outside local market in defined circumstances
    - Product or capacity not available locally
    - Reinsurance
  - Insurance on the internet
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# “operating in a jurisdiction” as an insurer may come with limits

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- Sometimes law restricts other activities that insurers can do.
    - Other financial businesses
    - Property developments
    - Non financial operations
  - Reasons
    - Financial contagion
    - Reputational contagion
    - Undue risk from related activities
    - Complication in supervision
      - For example, what is the right amount of capital?
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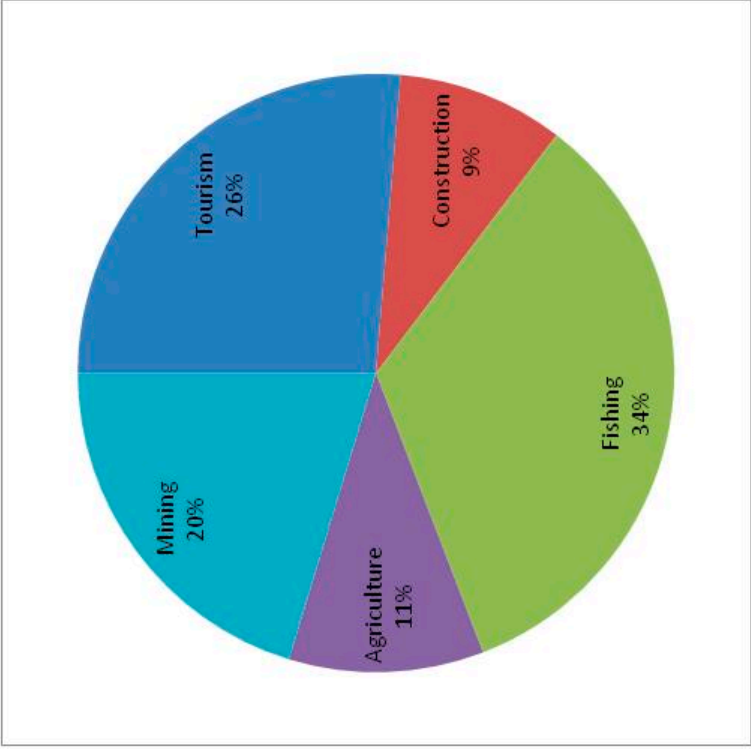
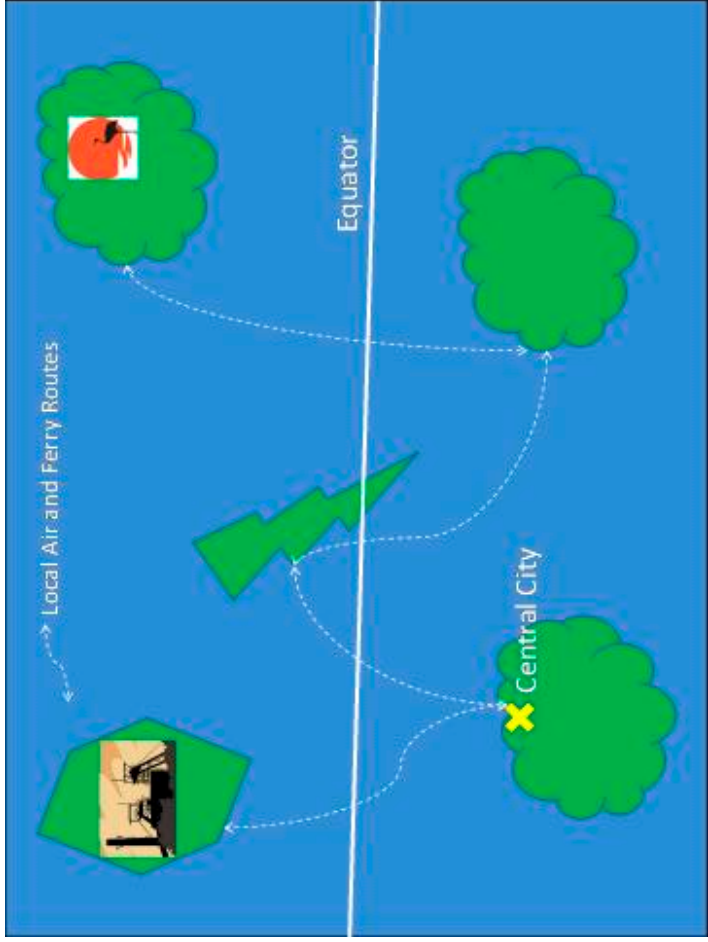


# **CASE STUDY – PART 1**





# About Wonderland





# Insurance Law and ICP6

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When reviewing the legal and supervisory arrangements for licensing, do you consider that the requirements of the IAIS Insurance Core Principle number 6 are observed?

1. Essential criteria a, b and g;
  2. Essential criteria c, d, and e;
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The Key Question: Whether or not to license an applicant

# LICENSING CRITERIA

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# Criteria

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- are “clear, objective and public”. With these characteristics, it is better for
    - Consumers
    - Insurers
    - The Insurance Supervisor
  - make it
    - clear what is required to enter the market
    - more difficult for undesirable insurers to be licensed
  - facilitate a smooth licensing process
  - reduce potential for political or industry interference
  - May be influenced by government policy, encouraging development, allowing domestic players to improve, facilitating competition, etc.
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## ICP 6 Essential Criteria (b)

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- Provides a list of items that can be criteria:
    - Fit and proper officers
    - Suitable owners
    - Enough capital
    - Systems and processes in place to effectively operate the business
    - Robust business plan including financials
    - Happy home supervisor (when relevant)
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# Suitable Functionaries

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- Key people must be suitable to perform their roles:
    - CEO, Directors, Senior Management, Actuaries, Auditors
    - Chief local person in the case of a branch (chief legal representative / chief agent)
  - Need to assess
    - Qualifications, competence, experience
      - May include professional association membership, employment history
      - relevant to each particular position
    - Integrity
      - Difficult to assess and enforce (eg disqualifying a person based on a doubtful reputation instead of fact)
      - Laws often have requirements for disqualification rather than qualification
      - May use additional information (police record checks etc)
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# Suitable Owners

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- “Those with significant holdings can influence the operation” (text page 17)
    - Look for who has influence and how it is exercised.
  - Includes people as well as other corporations
    - People might be unsuitable for ethical or competence
    - Other corporations may be unsuitable if they have objectives inconsistent with a well run insurer.
  - Suitable owners can be a source of financial strength / supply capital
  - Structure should not hamper supervision
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# Capital

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- Regulatory minimums
    - Initial nominal levels
    - Ongoing requirements based on business size and risk
  - Careful review of business plan is required.
  - Initial risk may be higher than ongoing risk
    - Start up costs
    - Incomplete business experience
    - Absence of experience data
    - New business concept drives new proposal
  - In few cases, higher requirements might apply to start ups or new initiatives
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# Systems

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- Particularly for risk management
  - Also administration, record keeping, reporting, asset custody, investment management.
  - Assess by examining
    - Written policies
    - Procedures and manuals
    - Inspection “kick the tyres”
    - Organisational structure
  - Proportionate to the nature and scale of the operation
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# Business Plans

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- ICPs suggest three year projection minimum
  - Coherent, complete, rational, plausible – so assess against strategy in qualitative as well as quantitative way
  - Include
    - Need to identify products, markets, distribution, etc
    - outline of reinsurance program
    - Projected income, costs, assets and liabilities and capital position
  - May be useful to obtain financial projections on a range of assumptions
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# LICENSING PROCESS

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# Key steps vary, but may include

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- Early / preliminary discussion with potential applicants
    - Provide information on process
    - Provide information on application requirements
    - Cut out any completely misinformed cases
    - Can explain any government policy positions
  - Company to be registered with relevant authorities
  - Formal application submitted for review
  - Feedback and revision as required
  - Final approval or otherwise
  - Operations to commence within a defined period
    - Avoid unused licenses in force indefinitely
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# Foreigners

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- Contact the home supervisor and seek advice
    - Need to have ongoing contact point identified
    - Insurer may not be operating soundly in home market
    - Insurer may be operating soundly but not well placed for expansion
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# Ministries and Supervisors

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- Other authority may be the licensing authority but supervisor has to deal with the licensed entity so should be significantly involved in all cases (Refer ICP)
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# **CASE STUDY – PART 2**





# Homerun Insurance Services Application

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1. When reviewing the application, do you consider that it provides all of **the elements that are required under the legal obligations**? If not, what elements do you feel are missing or less than fully adequate?
2. With respect to the **corporate governance, structure and fitness and propriety obligations**, do you feel that the proposal is acceptable? If not, what shortcomings or concerns would you have?
3. With respect to the **financial information provided** in the application, do you feel that the application is acceptable? If not, what shortcomings or concerns would you have?

What action would you propose that the Commissioner takes as a result?

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**END**

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