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The Financial Regulations

A Legal Perspective

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Overview

- The Finance Regulations (the **Regulations**) are the single most important piece of regulation enacted for the insurance sector in the UAE to date.
- They are a tailored set of regulation designed specifically for the needs of the UAE insurance market.
- There are separate Regulations for conventional insurance and takaful.
- They are not simply a cut and paste from Solvency I or Solvency II.
- Implementation periods of 1 – 3 years for different sections, but essentially require action NOW!
- The regulatory requirements will evolve over time.

Overview

- The Regulations:
  - impose substantial duties on the Board of Directors;
  - require structural changes to the operations of many insurers;
  - Impose substantial reporting obligations for insurers
- Place a unique level of emphasis on the role of the Actuary
- Create new requirements for document retention
- Enhance the powers of the IA to inspect records and examine individuals

Timelines for implementation

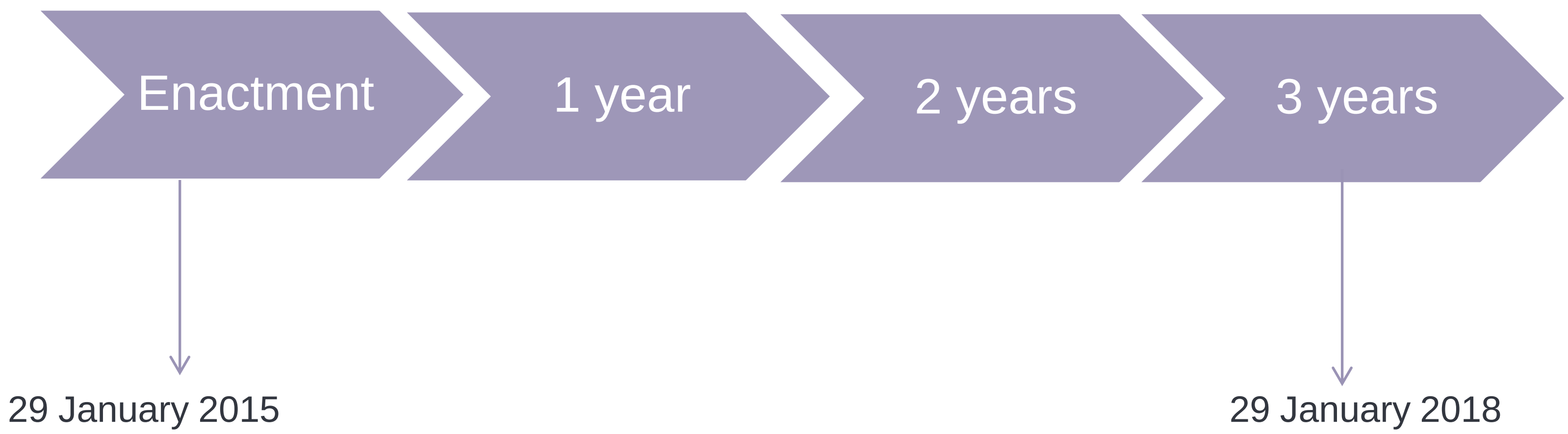
Scope of the Regulations

- Investing the Rights of the Policyholder
- Solvency Margin and Minimum Guarantee Fund
- Calculating Technical Provisions
- Assets that Meet Accrued Liabilities
- Records
- Accounting Books
- Accounting Policies & Financial Statements

Issued by the Insurance Authority
on 28 December 2014

Published in the Official Gazette
on 29 January 2015

Timeline for compliance



But note: Article 7 of Part Two of the Regulations:

> “During the alignment period of this regulation the Company shall provide the Authority with the financial reports, solvency templates and reports as required by the Authority that demonstrate progress in aligning its operations according to the requirements and regulations herein. These reports shall be provided within the same period as the interim and annual audited financial statements.”

Timelines for compliance

Investing the Rights of the Policyholder

- Maximum exposure to real estate – 3 years (29/1/2018)
- Maximum exposure to other assets – 2 years (29/1/2017)

BUT: START TO CONSIDER EARLY!

- Exemption for investment in real estate up to 40% upon request from the company accompanied by investment risk analysis report
- Exemption for derivatives exceeding 1% if to hedge against currency fluctuation

Timelines for compliance

Solvency Margin and Minimum Guarantee Fund

Assets that Meet Accrued Liabilities

- 3 years to implement (29/01/2018)

Calculating Technical Provisions

- 2 years to implement (29/01/2018)

Timelines for compliance

Records

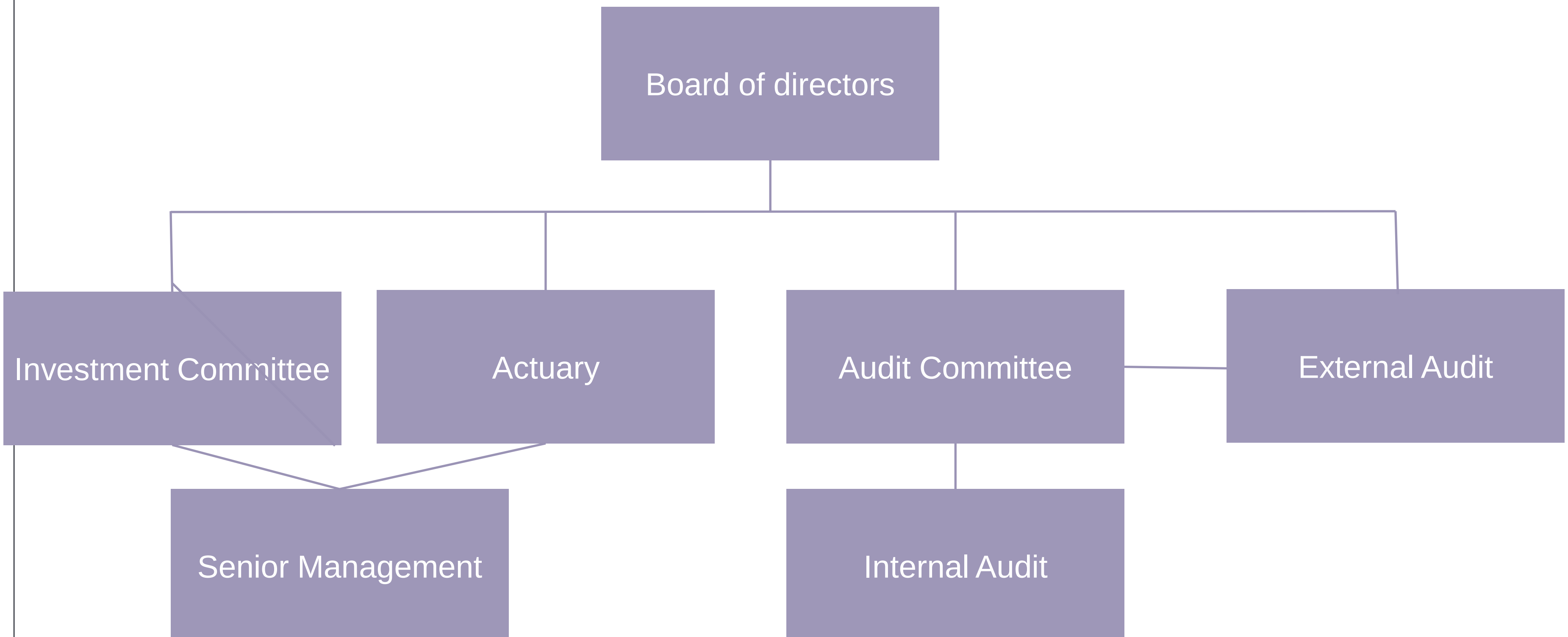
Accounting Books

Accounting Policies & Financial Statements

- 1 year to implement (29/1/2016)

Structural Considerations

Corporate Structures



Responsibilities – The role of Board

- The role of the board is emphasised throughout the Regulations.
- The board of directors (**BOD**) has primary responsibility for ensuring compliance with the Regulations.
- Key obligations include:
  - Determining the investment risk appetite of an insurer (S1, Article 2(1)).
  - Reviewing and approving the investment and risk management policies on an annual basis (S1, Article 2(1)).
  - Approving the Investment Committee charter, investment policy and guidelines (S1, Addendum 2(2)).
  - Electing the Investment Committee (S2, Addendum 2(2)) and Audit Committee (S.6, Article 4(5)).
  - Appointment of actuary (S. 3, Article 4(1)).

Responsibilities the role of the Board

- Responsibility for derivative transactions (S1, Addendum 4(2))
- Responsible to manage risks of investment outsourcing arrangements and for the compliance by provider with fiduciary and professional duties (S.1, Addendum 5(2)).
- Receiving reports on breaches of investment limits, large exposures and concentration risk (S1, Addendum 3(2)).
- Receive report from actuary of immediate or future risks impacting on the ability to fulfil short term and long term liabilities and recommend corrective actions, and forward all related information to the Authority, including the recommendations related to the report (S. 6 Article 4(4)).
- Board report to be included in financial statements.

Responsibilities of the Chairman of the Board

- Additional emphasis is placed on the role of the Chairman of the BOD.
- Key obligations include:
  - Endorsing the annual risk analysis report of the insurer's investment portfolio, strategy and management process (S.1, Article 10).
  - Endorsing the solvency template to be submitted annually to the IA (S.2, Article 9(1)).
  - Certifying a Financial Condition Report where requested by the IA (S.2 Article 10).
  - Endorsing the annual submission of the Technical Provision to the IA (S. 2 (5)(2).
  - Sign the annual financial statements (S. 7, Article 3(3))

The Investment Committee

- BOD level committee and appointed by the BOD (S. 1 Addendum 2(2)
- Membership from the BOD, Executive Management or member of any other committees established by BOD.
- Must have own charter, investment policy and guidelines (S1, Addendum 2(2))

Responsibilities of the Investment Committee

- Minimum responsibility is:
  a) Establishing the investment strategy and policy for approval by the board
  b) Settling the investment guidelines
  c) Reviewing / monitoring the investments
  d) Determining scope of audit procedures to include coverage of investment activities
  e) Assisting board in evaluation of adequacy and efficiency of investment policies and procedures applied in day-to-day management through audit reporting (S.1, Addendum 2(2))

Responsibilities of the Investment Committee

- To ensure adequate separation of duties between execution, recording, authorisation, reconciliation and related assurance (S.1, Article 1(3))
- To approve mark-to-model measurement of investments (S.1 Addendum 1(6))
- Must be aware of (S.1, Addendum 1(7)):
  - positions that are subject to market-to-model valuation;
  - the materiality of such valuations in reporting the performance of the business; and
  - the associated risks of the mark-to-model valuation

Responsibilities of Senior Management

- No definition of "senior management."
- Key obligations include:
  - To implement investment risks polices and procedures (S.1, Article 5(2))
  - To ensure that the Investment Committee is aware of the positions which are subject to the 'mark-to-model' valuation and understand the materiality of the uncertainty in the reporting of the performance of the business of the Company and the risks to which it is subject (S.1, Addendum 1(6)).
  - Managing and reviewing the investment policies of the Company and reporting to the Investment Committee, including
    - Ensuring proper day-to-day implementation of investment policies, procedures, practices and controls approved
    - management of business in accordance with the established levels of risk appetite;
    - Timely and regular reporting to the Investment Committee of the Company's investment activities;

Responsibilities of Senior Management

- Establishing adequate internal controls to ensure that assets are managed in accordance with approved investment policies, and in compliance with legal, accounting and relevant risk management requirements.
- Ensuring that investment procedures are documented and subject to effective oversight; and
- Ensuring adequate segregation of duties between execution, recording, authorization, reconciliation and related assurance activities.

– Developing a risk management policy for use of derivatives (S1. Addendum 4(4)), including regular reporting to senior management on such use.

– Periodic review of the derivative risk management policy (S.1 Addendum 4(5)).

The Actuary

- The role of the Actuary is at the centre of the Regulations.
- Mandatory for the BOD to appoint an actuary for both life and general business.
- Actuary must be registered with the IA.
- Company must notify the IA of the appointment of the Actuary and provide reasons for any change.
- Actuary cannot claim confidentiality in work undertaken for an Insurer against IA (S.5, Article 4(2)).
- Annual Report is to include the Actuary's report.

Responsibility of the actuary

- Certification of annual risk analysis report in relation to investments (S. 1, Art 10(2)).
- Certification of “mark-to-model” valuations (S.1, Addendum 1(6)).
- Certification of solvency template (S.2, Article 9)
- Certification of quarterly report on Solvency Capital Requirement (S.2 Article 9).
- Certification of Financial Condition Report (S.2, Article 10).

Responsibility of the Actuary

- Responsible for determining the quality of data used for the purposes of calculating the Technical Provisions (S. 3, Article 4(3))
- Annual report to IA addressing immediate or future risks facing the insurer, including prejudices the insurer's ability to meet its liabilities and capital adequacy currently or in the future (S.3, Article 4(5))
- Assessment of Technical Provisions and certifying quarterly and annual report on technical Provisions (S. 3, Article 5)

Responsibilities of the Actuary

- To provide adequate explanation to the actuarial methods adopted for calculation of IBNR and the methods should be consistent from year to year.
- Where Actuary decides to change the methods previously adopted and this methodology change has a material impact on results, sufficient explanation on the reason and impact needs to be provided to the IA (S.3, Addendum 1(2)).
- In the event of immediate or future risks facing the Company that would hinder the Company from fulfilling its short term and long term liabilities, the Actuary should submit a report on a timely basis directly to the Company's BOD(S. 6, Article 4(4)).

The Audit Committee

- Insurers are required to form an Audit Committee:
  - At least three members from non-executive managers (a Chairman and two other members)
  - One member must be an expert in financial and accounting affairs.
  - Members from BOD, executive management or any of the other committees
  - One or more members may be from outside the where the number of non-executive Board of Directors members is not sufficient.
- To meet at least once every three months, or whenever necessary.

(S.6, Article 4)

- Internal audit department to report to the Audit Committee
- External auditor to report risks and control deficiencies to Audit Committee

Responsibility of the Audit Committee

- Relatively few express obligations are mentioned in the Regulations:
  - In conjunction with the Investment Committee, to determining the scope of the rigorous audit procedures that include “full coverage” of investment activities, and ensure timely identification of internal control weaknesses and operating system deficiencies (S.1, Addendum 2(2)).
  - To arrange audit report on the adequacy and efficiency of the investment policies, procedures, practices and controls applied day-to-day (S.1 Addendum 2.2)

The Internal Audit Department

- Insurers are required to establish an Internal Audit department which reports directly to the Audit Committee.
- The Internal Audit Head in charge of this department must: (i) hold a professional audit qualification; and (ii) have relevant and adequate experience.
- The Internal Audit Department must be commensurate with the size and nature of the business exists and is operating effectively.
- Insurers must:
  – have an annual audit plan
  – perform annual risk assessment in accordance with the annual audit plan.

Responsibilities of Internal Auditors

- Evaluate and provide reasonable assurance that risk management, control, and governance are functioning as intended for all required systems, processes and/or risks enabling the Company to meet its objectives and goals;

- Reports risk management issues and internal control deficiencies identified directly to the Audit Committee;

- Provides recommendations for improving the Company's operations, in terms of both efficient and effective performance;

- Evaluating the risk exposures relating to the achievement of the Company's objectives;

Responsibilities of Internal Auditors

- Evaluating the reliability and integrity of information and the means used to identify, measure, classify and report such information;
- Evaluating the information security and probabilities of exposure to its related risks;
- Evaluates regulatory compliance program with consultation from legal counsel;
- Evaluates the Company's readiness in case of business interruption; and
- Teams with other internal and external resources as appropriate.

External Auditors

- External Auditors to be appointed annually (S. 6 Article 4(1)).
- IA may appoint External Audityor if not appointed within 4 months of commencement of Financial Year (S.6, Article 4(2))
- Management letter by External Auditor to be submitted by the insurer to before the publication of the financial statements.

Responsibilities of External Auditor

- Authenticate a quarterly report and analysis of its investment portfolio(S. 1 Article 10)
- Authenticate an annual risk analysis report of the insurer's investment portfolio, strategy and management process (S.1 Article 10)
- Validation certificate of the solvency template to be submitted annually (S.2 Article 9).
- Review actuarial reports presenting immediate or future risks facing the insurer, and provide an opinion on such risks to the Insurance Authority (S.3 Art 4).
- Authenticate Technical Provisions (S.3 Art 5(2)).

Additional responsibilities of the External Auditor

IA may request External Auditor to undertake additional tasks, including:

- Submission of such additional information relating to the audited accounts as the Authority may specify;
- Enlarging the scope of the audit;
- Notifying the Authority of any financial violations discovered during the course of the audit;
- Notifying the Authority of any reservations regarding the accounts or the reserves of the Company;
- Notifying the Authority of any discrepancy in the financial systems, controls, and of any material inaccuracies or inconsistency in the Company's financial statements; and
- Preparing such financial reports and statements as required by the Authority.

External Auditor's fees for such work is payable by the insurer.

Responsibility of Compliance Officer

- Insurers must appoint a regulatory Compliance Officer.
- The Compliance officer's role is to verify compliance with all rules, regulations and instructions.
- Report to the Chief Executive Officer.
- Compliance Officer is required to contact the Insurance Authority directly and provide it with information according to the procedures that are to be specified.

(S.6, Article 4(6))

Documentation and Reporting

Documents – Investing the Rights of the Policyholder

Investment and risk management policies	Must address overall investment strategy, risks management systems and oversight mechanisms. Separate strategy for life and non-life
	Addendum 2 for Investment policy
Risk management systems	To address risks associated with investment activities, including issues that affect coverage of insurance liabilities and capital adequacy
Investment procedures	To monitor: (i) asset limits; (ii) counter-party concentration limits; (iii) creditworthiness of counterparties
	Addendum 3 for risk policies and procedures
Stress-testing framework and policy	Regular testing (at least annually) for range of market scenarios and changing investment and operating conditions
Contingency Funding Plan	To address how the company will meet current and future liabilities in the event that it does not have adequate assets or liquidity of assets

Documents – Investing the Rights of the Policyholder

Investment Reports to IA	Quarterly report to analyse investment portfolio. Report to be authenticated by the external auditor and submitted 45 days from end of quarter
	Annual risk analysis report on the investment portfolio, strategy and management process, To be submitted with the annual audited financial results.
	Annual risk analysis report to be certified by the Actuary. Authenticated by the external auditor and endorsed by the Chairman of the Board.
	Annual risk analysis report to address the overall investment strategy an analysis of the investment portfolio and the market and liquidity risk, credit risk, including stress testing
Outsourcing Agreement	See next page

Documents – Outsourcing of Investment Activities

- Outsourcing to third party within the UAE to execute and manage its investment policy.
- Policies, procedures and limits for the outsourced service provider must meet the company's investment policies and procedures.
- The company is responsible for the performance of outsourced services.
- Copy of the outsourcing agreement to be provided to the IA upon request.
- Additional guidance in Addendum 5, note:
  - Company must have adequate expertise and resources in-house to monitor outsourced service provider;
  - Risk management system must monitor and asses risks on at least quarterly basis
  - Funds must be segregated and not co-mingled with other funds managed
  - Must be contractual obligation on service provider to provide sufficient information to evaluate compliance

Documents – Solvency Margin and Minimum Guarantee Fund

Documented Risk Management Framework and Strategies	Risk management Policies and Procedures
	Allocated Responsibilities and Controls
	Stress Testing framework and policy
	Further details in S. 2 Addendum (2)
Annual submission of solvency template	Must include validation certification by Actuary and the External Auditor and be endorsed by the Chairman
	To be submitted within 4 months of the end of the fiscal year and no later than 30 days prior to the AGM
Quarterly SCR Report	To be certified by the Actuary and submitted within 45 days from Quarter end.

Documents – Solvency Margin and Minimum Guarantee Fund

Financial Conditions Report	To be submitted at request of IA.
	To be certified by actuary and endorsed by chairman of the board
	To include: (i) actuarial certification of Technical Provisions; (ii) Risk-based analysis of investment portfolio, strategy and management process; (iii) an analysis of the SCR; (iv) an evaluation of the reinsurance structure and management process; (v) an analysis of underwriting, pricing and ERM policies and procedures of the Company
Report in the event of non-compliance with MCR or SCR attaching realistic recovery plan	Recovery plan to be approved within 30 days and must achieve compliance with regulations within 6 months
Report in the event of non-compliance with MGF attaching realistic recovery plan	Recovery plan to be approved within 30 days and must achieve compliance with regulations within 3 months
	Progress report to be submitted on implementation of recovery plam every 30 days

Documents – Technical Provisions

Unearned Premium Reserve / Unearned Risk Reserve

Outstanding Loss Reserve

IBNR

Allocated Loss Adjustment Expense and Unallocated Loss Adjustment Expense

Mathematical Reserve

Actuarial certification at least annually in annual report. The annual report is to address the immediate and future risks faced by the company and may include any matter that impacts on insurers' ability to meet liabilities or capital adequacy requirements (S.3, Art 4(3)).

Review by actuary to be both gross and net of reinsurance.

Pro forma report at Addendum 3 to S.3.

External auditor to review the actuarial report and provide opinion on risks set out therein (S.3, Art 4(6)

Quarterly report certified by actuary within 45 days of quarter end (S.3, Art 5(1))

Annual report certified by actuary, authenticated by the External Auditor and endorsed by the Chairman at same time as the submission of the audited annual financial results.

Documents – Quarterly Financial Statements

- To be signed by General manager and reviewed by the external auditor
- To be submitted within 45 days from end of the quarter

Documents – Annual Financial Statements

- To be audited by External Auditor and signed by the chairman of the board and the General Manager
- Must include:
  - External auditor's report and disclosures (based on S. 7, Appendix 1)
  - Notes to financial statements
  - Report of the Board of Directors
  - Report of the Actuary of the Company
  - Description of the roles of the Actuary and the External Auditor in the preparing on the annual financial statements
  - Management report (must comply with S. 7 Addendum 2)

The format of the financial statement forms is set out in the appendix to S. 7.

Record keeping

Books and Records

- Obligation to maintain complete transaction records for all local and international operations (including accounting books)
- Records to be maintained in UAE and easily accessible to the IA
- Segregation of records for life and general business, including such records necessary to identify all assets and liabilities for each class
- Backup for all records at a separate location
- Records in either hard copy or electronic format BUT must be in original form
- Electronic records are adequate if required controls in place and adhered to
- Retention period:
  - 10 years from the end of the working relationship with the insured
  - Plus 2 years from end of investigation or date of final verdict / settlement in legal proceedings
- IA have right to examine all records and can interview individuals
- The expense of IA appointing a third party to carry out inspections will be borne by the insurer
- Actuary to waive duty of confidentiality
- Separate requirements imposed on insurance agents and brokers.

Takaful Specific Provisions

Takaful Regulations

- The Takaful Regulations are recognition that Takaful operations differ in structure to conventional insurance. In particular:
  - Segregation of participants funds from shareholder asset
  - *Qard hasan* obligations
  - Shari'a compliant investments

- But also recognise that many of the risks to which Takaful operators are exposed are the same as their conventional counterparts.

- Aim is to create a level playing field.

Investments

- Role of the Shari'a committee to be clearly defined in order to ensure effectiveness of Shari'a governance (S.1. Addendum 2(10)).
- Investments are required to be Shari'a compliant (S.1, Article 3(8)).
  - Procedures for compliance; and
  - Procedures to address purification process (S.1, Addendum 2(10)).
- Takaful operator to have different investment strategy for:
  - Participants' investment fund
  - Participants risk fund; and
  - and shareholders fund (S.1, Article 2(9) and (10)).
- Investment strategy should take into account any Qard (S.1, Article 2(9)).
- The Contingency Funding Plan must include details of the Qard facility (S.1, Article 2(11)).

Solvency Capital Requirement (S.2, Article 4)

- The SCR is the required solvency level of the combined Participant Risk Funds and the Shareholders Fund.
- The SCR will take into account the same factors as for conventional insurers (i.e. underwriting risk, market and liquidity risk, credit risk and operational risk).
- In addition:
  - The reserve on the PRF is ensure that it can meet claims;
  - Adequate capital resources for the Shareholder fund to meet financial and legal obligations and to provide Qard.
  - The entire shareholders fund is available to provide Qard.
  - Must take into account the fluctuation in the valuation of assets.
  - Assets earmarked for Qard must be accounted for separately and valued in accordance with Asset Valuation instructions.
  - The right to recoup Qard is not an asset for the purposes of the Shareholder Fund.

Assets to meet accrued liabilities (S.4, Addendum)

- Qard is to be treated as receivable and considered in calculation of SCR / MGF as an unsecured and uncovered loan.
- Qard to be written off if outstanding for 3 years.
- Qard to be considered separately for each financial year.

Records

- Records of the wakala and mudaraba fee details are required to be maintained
- Records of the investments must include an ijara register and ijara documents.

(S.5, Addendum)

- Accounting books must include separate books for:
  - Accounting books for shaerholders
  - Wakala and mudaraba fee accounts
  - Ledgers and sub-ledges for participants and shareholders
  - Journals for participants and sharehodlers

(S.6, Article 1(1) and (3))

Financial Statements - Fees

- Specific pro forma financial statements included in the Addendum to the Takaful Regulations.
- Article 3 of S. 7 provides in relation to fees:

  "takaful operators shall charge fees either based a [Combined] model (Wakala fees as a percentage of total subscriptions and Mudaraba fees as a percentage of investment income) or only a Wakala Model (fees charged as a percentage of surplus income from underwriting and investment)."

- The model is to be approved by the Shari'a committee and the IA.

Financial Statements – Limits on fees

- New limits on fees:
  - May not be more than 35% of gross written contributions and participant investment revenues per financial year;
  - Shareholders fund is to bear all operational, administrative and general expenses for the business.
  - No separate expenses to be born by the participant fund.
  - IA to provide separate figure for Family Takaful.

- 1 year grace period for operators to comply.
- Financial statements must include disclosure of remuneration of party responsible for investments.

Financial Statements – Surplus / Deficit Allocation

- A policy for determining the surplus / deficit must comply with AAOIFI standards and be approved by the Shari'a committee and the IA (S. 7, Article 4)
- Different models of surplus allocation permitted (S. 7, Article 4).
- Different models for deficit in participant risk fund (S. 7, Article 2):
  - Settlement from reserves;
  - Qard hasan
- Different policies:
  - permitted for different types of insurance products;
  - required for family takaful and general (S.7., Article 4)
- Surplus / deficit to be determined with actuary for family takaful
- Disclosure in financial statements of: (i) the surplus / deficit policy; (ii) the allocation of undistributed underwriting surplus in the event of the operator's liquidation.

Miscellaneous

Key provisions for branches of foreign insurers

- In general the provisions of the Regulations apply equally to branches and locally incorporated insurers.
- Except:
  - Investment policy and stress-testing framework may be at head office (S.1, Article 2(6)).
  - Asset allocation and distribution limits and domiciliation rules only apply to the insurance funds backing UAE policies (S.1, Articles 3(7) and 6(3)).
  - The MCR only applies at head office level.
  - SCR applies only at the UAE level (S. 2, Article 3)
  - Annual Financial Statement does not include a management report (S. 7, Article 3(3)).

Key provisions for unit-linked business

- United Linked Insurance Policies defined as:

  “Insurance plans that provide the option to invest in any number of qualified investments, such as stock, bonds, mutual funds.”

- The following rules do not apply to such business:
  - Requirements for assets to have characteristics of safety, yield and marketability and to be diversified and adequately spread (S.1, Article 1(7)).
  - Asset distribution and allocation limits (S.1, Article 3).
  - The rules relating to domiciliation of assets (S.1, Article 6).
  - The rules requiring investments equating to technical provisions to be maintained in the UAE (S. 3 Article 2).

- Technical Provisions (including Mathematical Reserves) considered for Solvency purposes should not include unit-linked funds’ reserves except for the guaranteed portion of the policies (S.3, Addendum 2(19))
- For asset valuation purposes the technical provisions for benefits under unit-linked policies must be represented by the units or where there is a guaranteed benefit by assets satisfying S. 4 Article 1(3) with regard to security, quality, liquidity and profitability.

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