



International Actuarial Association  
Association Actuarielle Internationale

# IAA Risk Book

## Addressing the Consequences of Insurance Groups

Insurance Regulation  
Committee

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# **IAA Risk Book**

## **Addressing the Consequences of Insurance Groups**

**This Risk Book chapter has been developed and approved  
by the Insurance Regulation Committee of the IAA**

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## Comment and feedback

Comment and feedback on Risk Book chapters is welcomed.

To provide comments on chapters of the Risk Book or to report any problems with the website, please send an email directly to: [riskbookcomments@actuaries.org](mailto:riskbookcomments@actuaries.org).

## Version

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## Introducing the IAA Risk Book

The actuarial profession has contributed significantly to the development of risk management tools and processes, in insurance, pensions and related industries. Actuarial skills are also increasingly being applied in new and developing areas of knowledge.

Actuarial practice continues to improve the understanding, measurement and communication of risk and risk events and their implications through the development of tools and increasingly processes to manage the future uncertainty of risks in a sustainable and transparent way. These tools and processes trace, manage and mitigate the acceptance and transmission of the uncertain outcomes of risks.

The Risk Book is intended to provide high-quality reference materials to support a better understanding of the risks and inherently uncertain future outcomes that need to be managed when delivering financial services products – whether they involve insurance, investments or retirement incomes, or more broadly. The Risk Book is written to be accessible to a wide range of readers, many of whom may not be actuaries or experts in the areas discussed but may be decision-makers in those areas. Consequently, the Risk Book should provide insight into the ideas and concepts behind actuarial topics and concepts. It is therefore focused on being descriptive rather than being formal and mathematically precise.

All the Risk Book chapters are publicly available on the IAA website and are periodically updated. See [www.actuaries.org](http://www.actuaries.org) and follow the path to 'Knowledge / Publications / IAA Risk Book'. A discussion of their structure and relationships is provided in the Chapter: *Introduction – Using the Risk Book*.

The Risk Book is intended to be a dynamic and evolving resource, updated over time, reflecting new areas where actuarial expertise can add value, experience and advances, and topics of current interest and importance. It is electronically distributed to support ongoing updates. Risk Book chapters will be reviewed periodically at least every 5 years and more frequently if significant changes or developments occur.

The development and maintenance of the Risk Book is managed by the Risk Book Editorial Board of the IAA Insurance Regulation Committee.

Many people, mostly actuaries, have contributed to the Risk Book. Contributors are listed on the website.

To submit comments or questions about this Risk Book chapter, or to report any problems with the website, please email [riskbookcomments@actuaries.org](mailto:riskbookcomments@actuaries.org). To express interest in becoming involved with the Risk Book please go to the website and provide the requested information.

## 1 Executive Summary

This Risk Book chapter addresses considerations related to the management and oversight of insurance groups.

A group is generally defined as a collection of companies under common ownership and/or control. The International Association of Insurance Supervisors (IAIS) has adopted the definition<sup>1</sup> that a group is considered to be an insurance group for the purpose of group-wide supervision if there are “two or more legal entities, at least one of which is an insurance legal entity, where one has control over one or more insurance legal entities and possibly other non-regulated legal entities, and whose primary business is insurance”.

Importantly, one entity in the insurance group has significant influence (“control”), either directly or indirectly, over other entities in the group. This entity may be an insurer or may be a holding company with no direct business operations other than managing other members in the group. Regulators refer to this entity as the head of the group.

The continued growth and globalization of insurance and insurance groups have led to increased regulatory focus on insurance groups. Recognizing the importance of insurance groups in the insurance market, this chapter identifies major observations about the operation of such groups.

Key issues relating to insurance groups that arise for some or all of boards, senior management, financial analysts, actuaries/risk managers and supervisors include the following:

### 1.1 For the Management of Insurance Groups

- There is a need for a group-level enterprise risk management (ERM) function supported by local risk functions.
- Identification of all the material linkages between members of the insurance group and their associated risks, including concentration or accumulation of risk exposures (both direct and indirect), is very important for the risk and capital management of the group as well as its prudential supervision.
- Understanding and managing the fungibility of capital across the group as well as the adequacy of capital on both a consolidated and individual-entity-level basis within the group are key management activities.
- Members of the insurance group and its head need to understand the roles, expectations and requirements of their respective involved supervisors.
- The head of the insurance group has ultimate responsibility within the group for meeting the expectations and requirements of the group-wide supervisor.

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<sup>1</sup> IAIS Glossary at [www.iaisweb.org](http://www.iaisweb.org) as of 11 October 2022.

## 1.2 For the Supervision/Regulation of Insurance Groups

- The group-wide supervisor, in cooperation and coordination with involved supervisors, plays a lead role in effective group-wide supervision, including addressing any resolvability<sup>2</sup> issues.
- The cooperation and coordination of all involved supervisors, in carrying out their roles as local supervisors and as members of the supervisory college,<sup>3</sup> are important to the effective supervision of the group.

## 1.3 For the Actuarial Function

- Actuaries involved in risk management generally, and control functions specifically (i.e., those identified by the IAIS in Insurance Core Principle (ICP) 8 with respect to actuarial matters and risk management control functions), throughout the insurance group have appropriate regard not only to their entity-specific responsibilities/risks but also for the wider group context/risks within which their work is conducted.
- The head of the insurance group should have adequate access to actuarial expertise with a group-wide perspective (e.g., group-level Own Risk and Solvency Assessment, or ORSA). For some insurance groups, supervisors may require the establishment of an actuarial function at the group level.

## 2 Introduction

A group is generally defined as a collection of companies under common ownership and/or control. The complete International Association of Insurance Supervisors (IAIS) Glossary defines<sup>4</sup> an insurance group as

Two or more legal entities, at least one of which is an insurance legal entity, where one has control over one or more insurance legal entities and possibly other non-regulated legal entities, and whose primary business is insurance. ‘Insurance group’ includes insurance-led financial conglomerates.

Importantly, one entity in the insurance group has significant influence (“control”), either directly or indirectly, over other entities in the group. This entity may be an insurer or may be a holding company with no direct business operations other than managing other members in the group. Regulators refer to this entity as the head of the group.

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<sup>2</sup> Resolvability means firms need to be able to show how the preferred resolution strategy set for them could be carried out in an orderly way. This includes showing that they have identified any risks to their successful resolution. Source: [www.bankofengland.co.uk](http://www.bankofengland.co.uk)

<sup>3</sup> Supervisory college: a type of coordination arrangement to foster cooperation and coordination between involved supervisors with regard to the supervision of an insurance group, as well as to promote common understanding, communication and information exchange. Source: IAIS Glossary.

<sup>4</sup> IAIS Glossary at [www.iaisweb.org](http://www.iaisweb.org) as of 11 October 2022.

This IAIS definition of an insurance group is used in the remainder of this chapter for ease of communication to readers.

Insurance groups may be part of a broader group of entities that involve other financial sectors (e.g., banking and/or securities). Such groups are called financial conglomerates. (See the IAIS Glossary for the definition of a financial conglomerate.<sup>5</sup>) Insurance groups may also span multiple jurisdictions.

Insurance groups present unique issues, or issues with a different priority relative to stand-alone insurance entities. Interest in understanding these issues has grown since the global financial crisis (GFC) of 2008–2009. While insurance activities were not a cause of the GFC, the insurance industry and regulators alike have heightened their focus on the features of insurance groups that affect their governance, management and regulation. Actuaries throughout the insurance industry and within the regulatory community are playing key roles in each of these areas.

The remainder of this chapter describes some of the features of insurance groups versus legal entities (e.g., linkages, supervision/regulation) and concludes by describing the key issues relating to insurance groups that arise for a variety of stakeholders.

### 3 Insurance Group Linkages

A fundamental feature of an insurance group is that its members are linked or connected to each other in a variety of ways. The nature, extent and strength of these linkages vary significantly between groups and can vary significantly within a group depending on the agreements reached between the involved entities. The various entities of an insurance group are influenced by and are the ultimate responsibility of the head of the group. In one way or another, each entity in the group contributes to the overall business activities of the group. Some entities may represent geographic or product diversity. Others may represent different but synergistic businesses to insurance (e.g., investment or funds management). Others may provide specialized services needed by the group of companies (e.g., data services, customer service). Finally, some entities may operate largely independently of others in the group. Nevertheless, their financial results and risks contribute to those of the overall group.

Not unique to insurance groups, but also important to consider, are the linkages that may also exist between members of the group and various external entities that are not members of the group (i.e., not connected by ownership or investment – examples might include third-party providers of key software, data administration, contract administration, call centres, etc.).

Insurance groups employ a variety of linkages to facilitate synergies within different parts of the group, thereby leading to cost efficiencies, profit maximization, improvement in risk management, and more effective control of capital and funding. A useful supervisory paper on this topic is *Intra-Group Transactions and Exposures Principles*.<sup>6</sup>

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<sup>5</sup> Ibid.

<sup>6</sup> *Intra-Group Transactions and Exposures Principles*, 1999, Joint Forum, Basel Committee for Banking Supervision: [www.bis.org/publ/bcbs62.htm](http://www.bis.org/publ/bcbs62.htm).

In good times, all members of the group perform as expected and interact with each other as planned. At other times, internal and external stresses may cause difficulty to the operations of one or more members of the group. In turn, these stresses may stretch or even break one or more of the linkages within the group. In many cases the group will have the resilience to respond or provide support to affected members in the event that a single entity's actions within the group are insufficient to respond to the stress appropriately. Care needs to be taken that the group's capital resources are sufficient to withstand targeted levels of stress. Stress scenarios should consider integrated scenarios affecting the entire group, possibly resulting in multiple subsidiaries needing support at the same time.

The following paragraphs outline some types/aspects of linkage that are of importance to insurance groups.

### **3.1 Ownership**

Members of the insurance group are fundamentally linked through connected ownership or significant investment. Different terms are used to describe the extent of such ownership or investment. In some cases, reference is made to a "controlling interest", although there is no common definition for this term. For example, 51% ownership certainly constitutes a controlling interest, but such an interest may exist for lower rates of ownership if the other owners' interests are widely spread. Other terms used may refer to "significant investment" or "related undertakings".<sup>7</sup> Various stakeholders in insurance groups may have assigned specific meaning to certain of these terms to assist their understanding of the linkages within a group.

Insurance groups may be structured in a variety of ways. Some groups have all members 100% owned (directly or indirectly) by the same holding company, while others have various portions of minority ownership among the group members.<sup>8</sup> There may also be various subgroups within the overall insurance group, or various levels of holding companies spread throughout the ownership chain.

Groups may also exist that have no common ownership, but still exhibit common control (such as where there is a high degree of common management or a high degree of dependence through financial or operational support). Yet for risk management purposes, the most important issue in defining an insurance group or applying insurance group supervision is whether the operations (and solvency) of one group member are materially impacted by others within the group. In other words, are the members of the group interconnected or linked in some fashion in a material (solvency-related) way? There may be groups where this is not the case, and there are groups where not all group members are impacted by others in the group,<sup>9</sup> but those cases are not of interest for this chapter.

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<sup>7</sup> EIOPA-BoS-14/170 EN "Guidelines on treatment of related undertakings, including participations"; UK Companies Act 2006, Section 409.

<sup>8</sup> There can also be cases where the group has a minority interest in the equity of a member of the group.

<sup>9</sup> In such cases, the legal entity whose solvency is not impacted by others within the group can be viewed as merely an investment of the group, albeit one that may not be very liquid.

### **3.2 Governance**

Consistent with the concept of common control, groups frequently have a governance structure across the members of the group. The manner in which governance is carried out has both structural and style components. Both are important and relevant to risk management.

Responsibility for governance of the group rests with the head of the group, its board and its senior management team. Responsibility for governance throughout the group is then passed down through the other members of the group through their respective boards and senior management teams.

The degree of centralization or decentralization in such governance structures can vary significantly from group to group. In some cases, the head of the group assumes a more passive management role (e.g., decentralized), allowing its members considerable latitude to make business decisions independently. Other heads of groups assume a much more directive role (i.e., centralized), perhaps through insistence on a member of the head of the group serving also as a board member or as a member of senior group management in the member company. Both centralized and decentralized approaches have their advantages and disadvantages but either approach can be effective in providing necessary governance across the group. It is the responsibility of the head of the group to ensure effective governance is in place across the group, including within the head of the group. The role of corporate culture in the effectiveness of governance is provided as an example later in this chapter under the heading "Culture."

Some supervisors of subsidiaries will not want the head of the group to dominate the subsidiary board. In the view of these supervisors, the majority of the subsidiary board should consist of members focused on representing the interests of the subsidiary rather than those of the head of the group.

### **3.3 Capital Links**

Many groups have a centralized capital management function. This is especially important to the extent that capital providers view the group as a single entity. In such an environment, group capital is generally deployed to firms based on group priorities and legal entity regulatory capital requirements but not necessarily legal entity priorities.

Group capital management may rely on different types of capital instruments for various levels and legal structures within the group. The raising of capital through debt or equity offerings may occur at various levels within a group. In some cases, it may be easier or under more favourable terms for the issuance to be at the head-of-group level. In other cases, it may be preferable that a member of the group undertake the issuance. Once raised, the capital may be down-streamed to another member of the group as debt or equity. The repayment of external debt may be dependent on dividends received by the down-streamed recipient of the funds (if the downstreaming was in the form of equity contributions), or interest or principal payments (if the downstreaming was in the form of a loan)."

Legal entity capital in excess of regulatory capital requirements and supervisory targets may be paid upstream via dividend in accordance with group priorities. Higher-quality forms of capital will tend to be retained in the regulated entities as it may be preferable for these entities to exhibit the strongest solvency positions within the group. Alternatively, the downstream insurance entity may be minimally capitalized, but with an implicit or explicit solvency guarantee provided by the parent. In this case, the solvency of the downstream entity is reliant on the solvency of the parent. The supervisors of

subsidiaries may want the subsidiaries to retain capital in the subsidiary, to cover both the business objectives over the business planning period and reasonably foreseeable volatility, perhaps due to market conditions and/or underwriting results.

The fungibility of group capital is important. In addition to understanding how business plans may impact future capital fungibility, understanding how stress scenarios may impact the fungibility of capital, and developing contingency plans or strategies to maintain needed fungibility of capital in stress scenarios, are key aspects of group capital management.

Group capital management also involves consideration of the proper allocation among the member companies of the benefits of group operation. Examples of these include the group's overall deferred tax position and the value of risk diversification across the group.

Branches of group members may also be viewed as separate entities within an entity, depending on the degree of ring-fencing of assets that exist within the branch. Such ring-fencing may limit the assets of the branch that would be available to support the liabilities (and solvency) of the non-branch policyholders.

Lloyd's of London syndicates may also require separate investigation, as they have links to both their parent group (which can provide capital in the form of an assessable letter of credit) and to the overall Lloyd's of London structure.

### 3.4 Contractual Links

There may be contractual agreements between the entities within a group that link the survival of one group member to other group members. These can include:

- Intra-group reinsurance (see the *Reinsurance* chapter of the IAA Risk Book on this topic):
  - a) Quota-share reinsurance – using capital in one entity to reduce requirements in another with a corresponding change in where within the overall group the profit emerges.
  - b) Catastrophe, aggregate excess or other excess reinsurance agreements between group members. These typically would be written by the larger and/or “lead” member of the group protecting the smaller group members, either to be retained or to coordinate with third-party reinsurers.
  - c) Quota-share reinsurance pools (typically involving only group members within the same jurisdiction), such that the entities share equally the underwriting results of certain or all insurance policies written by pool members.
  - d) Quota-share pools within a group (which are very common if not the norm for U.S. property and casualty (P&C) companies) can result in the entire pool effectively being a single entity for risk management and solvency regulation. The entire pool survives or sinks as a whole. In such a case the pool members may be best viewed as a single entity for risk management and/or regulation purposes.
  - e) Reinsurance “mixer” companies (a “mixer” is an internal reinsurer established by a group to pool risks) may be used to help with achieving diversification of risks and lower capital requirements.
- Guarantees, such as loss reserve guarantees or performance guarantees.

- Service contracts, whereby some or all of the operations for one (or more) group member(s) are contractually provided by other group members.

Contractual links may not extend to all members of a group. Hence some members within a group may be more separable (or more interconnected) than others. Indeed, if a “multiple point of entry” (MPE) resolution strategy<sup>10</sup> is envisaged, assessing barriers to separation of entities or subgroups will be imperative.

### 3.5 Shared Resources

Many shared resources can exist within the group whereby the same resource is used and relied upon by multiple legal entities. Examples may include a common investment department, common finance department, common claim department, common IT platforms, etc. The degree of this sharing can vary within the group (e.g., claim departments may be shared within the same jurisdiction but not across jurisdictions). The sharing of resources within a group may be formally structured through the use of service contracts.

As mentioned earlier, different groups have different levels of centralization and decentralization, although they always have to address local legal and regulatory requirements. The IAIS gives one instance: “The supervisory regime requires insurers to maintain contingency plans and procedures based on their specific risk for use in a going- and gone-concern situation.”<sup>11</sup>

There may be a limit to the extent of resource sharing that can occur, and this may be a factor in any resolution planning.

Another issue that can arise from shared resources is shared outsourced resources. While risks associated with outsourcing can also exist for solo entities, such outsourcing at the group level can lead to additional solvency complications.

### 3.6 Business Management Structures Across Legal Entity Lines

A group can have a business unit structure that crosses over legal entities. A single legal entity can contain business from multiple business units, and a single business unit can share all the legal entities it uses with other business units. In short, the operational structures and the legal entity structures of the group may be very different.

### 3.7 Reputation Risk

Reputation risk is the damage that can occur to a business when it fails to meet the expectations of its stakeholders and is thus negatively perceived. Such damage can occur within any member of a group or even to the head of the group. However, there are links, some tangible and others intangible, between members of a group to the extent their customers and counterparties (including potential

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<sup>10</sup> Final guidance on insurance resolution strategies, Financial Stability Board, 2016: [www.fsb.org/2016/06/developing-effective-resolution-strategies-and-plans-for-systemically-important-insurers/](http://www.fsb.org/2016/06/developing-effective-resolution-strategies-and-plans-for-systemically-important-insurers/).

<sup>11</sup> IAIS ICP 26.6.

customers and counterparties) view the group members as part of the whole group. To the extent these parties view the group as a whole, any crisis (or success) of a group member may impair (or build up) these parties' view of other group members. This is frequently labelled "reputation risk" or "group reputation risk". Hence the risk management of one group member may be linked to that of other group members, even in the absence of any tangible linkage. (Note that this is not absolute, as some group members may not be viewed by their relevant parties as having any noticeable connection to their group – the general public may not even be aware of this connection.)

### **3.8 Culture**

Group members may also, to an extent, share the same culture. Where this exists, it may be driven by common management, by interactions among the various group members, by movement by employees across the group or other causes. To the extent a group culture exists, it affects the extent to which group members react the same way to certain stimuli.

As an example of the importance of corporate culture, the manner in which governance is carried out within the group can be significantly affected by the "tone from the top". Some heads of groups provide significant direction on business strategy or have focused views on risks to be assumed, risk appetites, etc. These groups are likely to share a common view of risk across the group. However, a potential weakness to be guarded against is a tendency for group member risk management capabilities to be underdeveloped (i.e., due to directive influence from the head of group). Other heads of group may permit a greater degree of independence to their group members to make business decisions and assume risk. These groups may feature more highly developed risk management capabilities within each member but the development of common or cohesive risk management across the group at the head of the group may be a challenge. Of course, both polarities of "tone from the top" can work effectively but groups need to be aware of their own strengths and weaknesses and the possible implications for risk and capital management.

The 2021 IAIS Issues Paper on Insurer Culture<sup>12</sup> discusses the importance of understanding an insurer's culture for effective insurance supervision. Its conclusion includes the following, "The culture of an insurer is influential in determining how effectively it delivers on critical outcomes related to its overall financial soundness, the interests of policyholders and other stakeholders, and the fair treatment of customers." For insurance supervisors, culture can be difficult to assess through quantitative means (e.g., reports) and is perhaps best assessed qualitatively through observance of working relationships and actions.

## **4 Capital: Group versus Legal Entity**

### **4.1 Amount of Capital**

A legal entity and a group will decide what level of capital is needed/desired to meet its business objectives, strategic plan (for future business) and commitments to policyholders and other

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<sup>12</sup> Issues Paper on Insurer Culture, p. 35, IAIS, November 2021, [www.iaisweb.org](http://www.iaisweb.org)

stakeholders.<sup>13</sup> This typically involves a formal examination of current and future capital needs using a variety of risk management and modelling tools. Many insurers and groups include this work within their regular ORSA process<sup>14</sup> (ORSA is described in more depth in the *ORSA* chapter of the IAA Risk Book.) The resulting target level of capital set by the legal entity and group will also be influenced and/or informed by the views of important stakeholders such as rating agencies and supervisors who will have their own perspectives on the amount and form of capital to be maintained. Supervisors will typically refer to a number of different levels of capital: a minimum level (i.e., a minimum capital requirement, or MCR) which when breached triggers strong supervisory intervention, and one or more higher levels, including a prescribed capital requirement (PCR). Successive breaches of these supervisory capital targets trigger increasing levels of supervisory interaction and intervention as the breaches signify increasing risk to policyholders' interests. These increased levels of activity should take into account the supervisory views of the legal entity and group risks to policyholders, and the adequacy of capital and its position within the group to provide for the group's risks.

The desired level (or adequacy) of capital may be assessed at the group level,<sup>15</sup> the entity level, or both (with "both" being the common approach). Important stakeholders such as rating agencies and supervisors may have different views on the desired level and positioning of capital throughout the group (e.g., fungibility of capital being an important issue).<sup>16</sup>

Either the group's consolidated accounts may be used as a basis or another aggregation method may be used. The former is already adjusted for intra-group holdings, and further adjustments may then need to be made to reflect the fact that the group may not behave or be allowed to behave as one single entity. This is particularly the case in stressed conditions. The latter method may sum surpluses or deficits (i.e., the difference between capital resources and capital requirements) for each insurance legal entity in the group with relevant adjustments for intra-group holdings to measure an overall surplus or deficit at group level. Alternatively, it may sum the insurance legal entity capital requirements and insurance legal entity capital resources separately to measure a group capital requirement and group capital resources. Where an aggregation approach is used for a cross-jurisdiction insurance group, consideration should be given to consistency of valuation and capital adequacy requirements (i.e., including relative levels of prudence) and of their treatment of intra-group transactions.

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<sup>13</sup> Note that capital may be measured differently by different stakeholders and for different purposes (such as legal or prudential/supervisory requirements, rating agency credit ratings, owner risk management policies, investors, owners and others). Capital is also sometimes segregated into quality tiers. Discussion of these facets of capital management is beyond the scope of this chapter.

<sup>14</sup> Jurisdictions may use different terms (e.g., ICAAP) for their implementation of ORSA.

<sup>15</sup> There may also be holding company liquidity targets, such as the need to maintain sufficient assets at the holding company to pay, say, one or two years of debt payments, dividend costs and other holding-company-level expenses, without needing capital or cash up-streamed from the holding company's subsidiaries to do so.

<sup>16</sup> For example, a jurisdiction may place restrictions on movement of capital into or out of the jurisdiction that may limit the ability or speed of any capital transfer.

It is not the purpose of group-wide capital adequacy assessment to replace assessment of the capital adequacy of the individual insurance legal entities in an insurance group. Its purpose is to require that group risks are appropriately allowed for and the capital adequacy of individual insurers is not overstated (e.g., as a result of multiple gearing and leverage of the quality of capital or as a result of risks emanating from the wider group) and that the overall impact of intra-group transactions is appropriately assessed.

## 4.2 Location of Capital (Including Capital Fungibility)

The ability of individual legal entities as well as the group as a whole to maintain sufficient capital and liquidity to meet the targets of each entity (or at the group level) can be dependent on the ability to access capital/liquidity elsewhere within the group (and the costs, including tax effects). In some cases, these sources are readily available or fungible in times of need. However, it is common for there to be a variety of restrictions that reduce the fungibility of such capital or liquidity, especially in times of stress.<sup>17</sup> Restrictions on or costs regarding the movement of capital resources into and out of an entity include: protections applicable to “with profits” or “statutory” funds; protected cell structures; legal restrictions on interest, dividend and capital movements out of an entity; tax implications; and foreign exchange restrictions. Hence the starting point in evaluating capital adequacy within a group is determining the capital requirements (legal and otherwise) for each entity within the group.

Evaluation of capital adequacy for the individual group members and the overall group is heavily dependent on the fungibility<sup>18</sup> of capital. Where assets are perfectly fungible within a group, the location of assets supporting capital is not an issue for evaluating capital adequacy within or across the group. In addition, where capital is fungible the group gets maximum benefit from diversification of risks across group members, reducing the level of capital required to support the group’s business. This diversification benefit is a major advantage of groups vis-à-vis stand-alone entities that operate in limited markets. Where capital fungibility is limited or restricted, full diversification benefits may not be achieved and capital adequacy of the individual group members becomes more important. This is one reason why some prefer to use the term “group capital *assessment*” rather than “*calculation*”.

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<sup>17</sup> In many cases there is no need for an overnight cash injection, and it is important to distinguish between resources to meet claims as they fall due and liquidity. Even so, from the supervisory perspective there is always a concern that the funds cannot be made available in times of stress, particularly where cross-border issues arise.

<sup>18</sup> The term “transferability” is sometimes used interchangeably with “fungibility”, although they have different meanings. “Fungibility” frequently refers to financial instruments being of such nature or kind as to be freely exchangeable or replaceable, in whole or in part, for another of like nature or kind. “Transferability” refers to the ability to convey or cause to pass from one place, person or thing to another. Fungibility tends to be a broader and more relevant question for group capital adequacy than the narrower concept of transferability. It is important to consider what purposes funds are required to fulfil and whether they can be achieved. Relevant questions may include: can title be transferred without loss? How long would it take to make the transfer of funds effective? After transfer, can benefits of ownership be enjoyed without restriction or loss of value? Post transfer, is there sufficient liquidity? (The funds transferred do not need to be liquid if there is sufficient liquidity elsewhere.)

There are a number of ways that a group can make funds in one entity available to another in the absence of full capital liquidity and fungibility. Common examples would be:

- Using intra-group reinsurance to reduce the capital requirement and possibly the liquidity need in the ceding entity (taking advantage of higher capital and/or liquidity in the assuming entity).
- Using external (ceded) reinsurance from one entity to reduce its required capital resources and so being able to use the freed assets to support another entity in difficulty.
- Using external (ceded) reinsurance for the group as a whole but directing any recovery to the entity suffering the losses.
- Intercompany loans.
- Guarantees within a group.
- Service contracts within the group (including the use of shared resources).
- Tax treaties (typically within a tax jurisdiction) that share the tax reductions caused by adverse experience and direct the cash benefit to the entity with the losses.
- Securitization of cash flows. It may be possible to sell future cash flows from portfolios of policies to another entity for a greater, and more certain, value than the regulatory valuation. Any risks created need to be allowed for and any residual risk carefully assessed.

Many of these arrangements or approaches to address group capital needs (and to maximize group diversification benefits) also create operational efficiencies. The use of shared resources allows for higher return on investment in IT systems, intellectual capital, service platforms and systems of controls (with the understanding that this can be overdone – local differences cannot be ignored).

An important consideration in assessing different arrangements or approaches is the degree of permanence associated with the instruments or structure introduced. Some approaches (for example, introducing certain types of long-term guarantees within a group) may introduce relatively more rigidity into the capital structure as they may have a long duration and may not be easily unwound. These implications, and how they may impact capital flexibility in the future, should be understood and taken into consideration.

Tax implications of different arrangements or approaches should also be well understood as they may also impact the rigidity of the capital structures as some structures may be relatively more difficult to unwind without significant tax cost.

While such arrangements or approaches can be sound ways to manage resources and address emerging issues, their use must also consider their effectiveness in times of stress.<sup>19</sup> For example, although intra-group reinsurance should have the same legal enforceability as external reinsurance, there may be concern that after an extreme event, the assuming entity will fail to meet its obligations.

The above discussion includes many approaches that might be used to address the location of capital and possible fungibility concerns. A valid supervisory concern, however, is whether any such arrangement has as its primary purpose the circumvention of restrictions on the movement of capital, with no other business purpose.

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<sup>19</sup> A third concern exists that relates to group resolutions and breakups. That concern is discussed later.

### **4.3 Capital Access and Quality of Assets**

Related to the issue of capital fungibility are the issues of capital access and the positioning of quality assets.

Groups frequently provide greater economies of scale regarding access to the capital markets. This relates to both issuance of common stock and long-term debt. The greater scale makes public financing easier to achieve, as the more securities issued by an organization, the more robust the secondary market, and hence the easier it is for investors to buy and sell the securities. This increased liquidity in the securities issued by the group makes it more attractive to investors, and hence may provide for lower costs of capital and easier access to capital in times of stress.

For some groups, the access to capital markets may be facilitated by issuance in a major capital market (e.g., the USA or the European Union, or EU). If the head of the group is not based in one of those jurisdictions, then capital access may be more easily achieved via the legal entity based in that market.

Where the group-level debt is concentrated at the ultimate parent in the form of a non-insurance company, there are certain considerations as to the treatment of this parental debt for group capital assessment purposes. The proceeds from such parental debt are generally contributed downward to the operating (insurance) entities. The holding company parent typically has limited assets other than its subsidiaries. Hence it uses dividends from the operating entities to the parent to service this debt (as to interest and principal payments). The insurance entities that received the debt issuance proceeds may be under no contractual obligation to dividend up the necessary funds to repay the debt and may be prevented from doing so by local laws and/or regulations. Hence the solvency of the group holding company may (in those jurisdictions) be separable from the solvency of the insurance members of the group. In other jurisdictions, the insurance subsidiaries can be forced to provide funds to repay the parent's debt (absent contractual stipulations in those debt instruments), such that the solvency of the holding company is inseparable from that of the subsidiaries.

Insurance groups also need to consider the optimal positioning of quality assets within the group. High-quality assets may attract lower capital requirements and tend to be highly liquid and fungible, but also tend to offer lower yields than other asset classes. As a result, a number of these features may be of greater benefit to insurance legal entities than to the head of the group, which may or may not be an insurance legal entity itself.

## **5 Other Important Aspects of Insurance Groups**

### **5.1 Multiplicity of Jurisdictional Regimes**

The management and supervision of insurance groups is frequently complicated by the multiplicity of jurisdictional regimes in which the various members of the group may operate. Due to their diverse activities (e.g., different businesses and geographies), groups are brought into contact with multiple regulators, each operating within its own jurisdictional authority (e.g., bank versus insurer, prudential versus market conduct supervision, country versus state).

Members of a group may operate in a variety of business sectors, industry segments, markets, geographies, product lines, etc., according to the group's overall business strategy. Beyond operations

in the insurance sector, member entities may operate in the banking or investment/securities sectors. Each of these three sectors has its own regulatory and supervisory requirements.

The legislative, regulatory and/or supervisory requirements on insurers operating in different geographies can result in the localized needs to structure that part of the insurance group's operations in a specific manner (e.g., subsidiary, branch, captive, ring-fenced).

## **5.2 Multiple Origins/Background**

Groups may grow organically or via mergers and acquisitions. Such growth can be the result of careful planning or opportunistic, or some combination of the two. The result can bring efficiencies to the operations of the group and group members (such as opportunistic growth via acquisition, although such a benefit is not guaranteed to occur). In addition, a structure that is optimal<sup>20</sup> at one point in time will not always remain so in the future. Hence nearly all groups are dynamic, changing their size and structure over time.

## **5.3 Multiple Environmental Pressures**

A group's structure will also be impacted by various pressures in the environment. These can include statutory restrictions, currency restrictions, and insurance market and financial market realities – these help shape the structure of insurance groups.

# **6 Supervision/Regulation of Insurance Groups**

## **6.1 Overview**

As noted previously in this chapter, the members of an insurance group may be subject to several types of supervision and regulation. For example, an insurance group with entities in insurance and/or banking and securities/investment sectors is subject to multi-sectoral supervision.

Financial sector supervisors are members of one or more of the IAIS, the Basel Committee for Banking Supervision (BCBS) and the International Organization for Securities Commissions (IOSCO). Members of the IAIS, BCBS and IOSCO develop and maintain their regulations and supervisory frameworks for solo entities and groups in accordance with their jurisdictional authority and guided by their relevant sectoral standards. Regular monitoring and assessment of each jurisdiction's substantial compliance with international regulatory standards (i.e., the Financial Sector Assessment Program, or FSAP) is the joint responsibility of the International Monetary Fund (IMF) and the World Bank (WB). In recent years, the IAIS has begun the assessment of its members' implementation of the IAIS Insurance Core Principles (ISPs).

The individual legal entities within a group subject to regulation are generally subject to solo supervision by their respective supervisors. Solo supervision can be challenging if operationally the

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<sup>20</sup> There may also be numerous facets of the environment that affect how a group may attempt to "optimize". For example, the optimal structure for reacting quickly in the market may not be the optimal structure for capital management.

group is not run along legal entity lines. The group as a whole will also be subject to supervision by a lead or group supervisor, frequently in conjunction with the supervisors of the individual group members (crossing both geographic and sectoral boundaries). Coordination among all involved supervisors, especially between the lead/group supervisor and the local supervisor(s) is a necessity as the legal authority over firms resides with the local supervisor/regulator, regardless of where the group is headquartered or whether the group's principal domicile has enacted a group supervision statute.

The IAIS uses the term "home supervisor" to refer to the supervisor of the jurisdiction in which the insurance entity is domiciled. It uses the term "host supervisor" to refer to the supervisor in any other jurisdiction in which the entity or group operates. Note that in rare circumstances the home supervisor of the head of the group may not be selected by the involved supervisors as the group-wide supervisor. This might occur (for example) if the domicile for the head of the group is different from the jurisdiction in which the majority of the insurance business is conducted. In most situations, insurance supervisors conduct solo supervision over the insurance operations in their jurisdiction, whether they are domestic or foreign (via branch or subsidiary) in origin. Within the EU, member states have agreed that the home supervisor is responsible for supervision of domestic as well as foreign (outside of the home jurisdiction) branch operations.

The geographic bounds within which a regulator has authority are set by its enabling legislation. Groups and their member entities tend to operate over different geographies and can therefore be subject to regulation and supervision by multiple authorities. Insurance supervision in the USA is typically state-based, although supervision at the federal level can also exist under certain circumstances for the largest systemically important insurance groups and those with a banking affiliate. In Europe, multiple countries are members of the EU or European Economic Area and are subject to maximal harmonization of laws at the country level. In some respects (but perhaps not all), members of the EU might be considered to operate as if they were a single jurisdiction.

While the insurance supervisor for a particular jurisdiction will generally handle all types of insurance, there may be separate divisions or departments within that governmental agency for different types of insurance (e.g., life versus health versus property/casualty). Hence there may be a need for supervisory coordination even within the same insurance supervisory body.

Many regulatory authorities (and their accompanying legislation and/or regulation) require that general insurance and life insurance business be conducted through separate legal entities. Such separation, which frequently includes regulation unique to each of these businesses, may or may not entail supervision by a common insurance supervisory organization. While groups may choose to combine various aspects of their insurance operations within a single entity, they may choose for business reasons to conduct certain specialized activities (e.g., reinsurance, captives, Lloyd's, other specialized sub-markets) through separate legal entities.

The insurance market conduct supervisor may or may not be within the same insurance supervisory authority that is responsible for prudential supervision. This distinction is handled differently from jurisdiction to jurisdiction.

Within each jurisdiction, the authority responsible for insurance supervision may also be responsible for other financial industry regulation, such as that for banks and/or investment securities. In that case the supervisor's responsibility may extend beyond policyholders, including possibly a

responsibility to capital providers (such as investors in the stocks and bonds issued by the group members). This may require the supervisor to balance the needs of various other stakeholders in addition to those of policyholders.

Where the supervisor has authority over both the solo entity and the group to which it belongs, issues may arise as to whether the needs of the entity or of the group come first. This prioritization may be a function of local law and authority. Some jurisdictions focus on supervision from the bottom up (putting solo entity needs first), while others may supervise from the top down (putting the group needs first, even if it could make a single entity vulnerable).<sup>21</sup>

## 6.2 Regulatory Standards

As noted earlier, financial sector supervisors develop and maintain their regulations and supervisory frameworks for solo entities and groups in accordance with their jurisdictional authority and guided by their relevant sectoral standards.

As the international setter of model standards for insurance supervisors, the IAIS has established a set of 25 ICPs and associated standards and guidance for each ICP.<sup>22</sup> As stated in introductory paragraph 15 to the ICPs:

The Principle Statements and Standards apply to the supervision of insurance legal entities and, unless otherwise specified, to insurance groups, including the head of the insurance group. The application may vary and, where necessary, further guidance is provided.

The implementation of the ICPs and standards relevant to group-wide supervision may vary across jurisdictions depending on the supervisory powers and structure within a jurisdiction. There are direct and indirect approaches to group-wide supervision, especially with regard to supervision at the group level. As a result, introductory paragraph 17 of the ICPs states:

Regardless of the approach, the supervisor must be able to deliver effective groupwide supervision, including that all relevant group-wide risks impacting the insurance entities are addressed appropriately.

While many of the ICPs contain important standards applicable for both solo entity and group supervision, ICP 23 (Group-wide Supervision) and ICP 25 (Supervisory Cooperation and Coordination) are of particular importance for the supervision of groups. To address the issues related to large internationally active insurance groups (IAIGs), the IAIS has developed a common framework (ComFrame), which builds and expands upon the high-level requirements and guidance of the ICPs and is included as sections within the relevant ICPs.<sup>23</sup> Further, in December 2022 the Financial Stability Board (FSB) endorsed the IAIS Holistic Framework for the assessment and mitigation of systemic risk in the insurance sector. The Holistic Framework is an integrated set of supervisory policy measures, a Global Monitoring Exercise (GME) and implementation assessment activities. The

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<sup>21</sup> This may also vary by financial sector within a jurisdiction, as is discussed later.

<sup>22</sup> See [www.iaisweb.org](http://www.iaisweb.org)

<sup>23</sup> As of the fall of 2022, various sections of this framework were under review for possible revision. The ICPs should be viewed as dynamic in nature, subject to periodic review.

ICPs, as well as news on ComFrame and Holistic Framework related developments, can be accessed via the IAIS website.<sup>24</sup>

IAIS standards include those related to prudential as well as market conduct supervision.

Insurance groups may be part of a larger cross-sectoral group known as a financial conglomerate (FC). To address some of the complexities arising from FCs, in 2012 the Joint Forum (JF) of international financial regulators published an influential paper, Principles for the Supervision of Financial Conglomerates.<sup>25</sup> As a result, some regulators have developed their own standards and guidance for FCs in their jurisdictions (e.g., FICOD in the EU).

The key principles arising from the JF paper, while addressed to supervisors, have obvious direct implications for insurance groups and the head of the insurance group in particular. The key principles are:

1. Supervisors should take steps, directly or through regulated entities, to provide that conglomerates have adequate risk management processes in place, including those pertaining to ITEs [intra-group exposures], for the conglomerate as a whole. Where necessary the supervisors should consider appropriate measures, such as reinforcing these processes with supervisory limits.
2. Supervisors should monitor material ITEs of the regulated financial entities on a timely basis, as needed, through regular reporting or by other means to help form a clear understanding of the ITEs of the financial conglomerate.
3. Supervisors should encourage public disclosure of ITEs.
4. Supervisors should liaise closely with one another to ascertain each other's concerns and coordinate as deemed appropriate any supervisory action relative to ITEs within the group.
5. Supervisors should deal effectively and appropriately with material ITEs that are considered to have a detrimental effect on the regulated entities, either directly or through an overall detrimental effect on the group.

## 7 Issues for the Management of Insurance Groups

Building on the preceding background surrounding the nature of insurance groups and their supervision, this section highlights issues for the management of insurance groups.

### 7.1 Need for Group-Level ERM

The formation of an insurance group creates risk exposures unique to the formation of the group itself and distinct from the stand-alone risk exposures of the member entities. These risk exposures arise from the various linkages between the member entities as well as from the head of the group itself. They can best (and in some cases solely) be managed by the head of the group.

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<sup>24</sup> [www.iaisweb.org](http://www.iaisweb.org)

<sup>25</sup> Principles for the supervision of financial conglomerates, 2012, Joint Forum, [www.bis.org](http://www.bis.org)

As a consequence, an ERM function at the head of group level is very important. This is consistent with having various key leadership and control functions within the head of the group.

In addition, identification of all the linkages between members of the insurance group and their associated risks, including concentration or accumulation of risk exposures, is very important for the risk and capital management of the group as well as its prudential supervision.

Involved prudential supervisors for the insurance group will expect the group to demonstrate sound risk and capital management for the solo insurance entities and the group as a whole, reflective of all relevant group linkages. Prudential supervisors may also expect insurance groups to develop contingency recovery plans in preparation for possible crises. For IAIGs, the IAIS has developed additional ComFrame standards and guidance. As mentioned earlier, group resolvability considerations may require an explicit determination of whether particular entities may be allowed to fail (a wider discussion on single point of entry (SPE) or MPE is included in the *Resolution of Insolvencies* chapter of the IAA Risk Book). Prudent disclosures of the group's risk exposures due to its various linkages will be of interest to various other stakeholders such as rating agencies.

Specific examples of the importance of ERM at the group level are outlined in the following paragraphs.

#### *Group Risk Concentrations*

Insurance groups assess the development of risk concentrations across the group and in aggregate as part of sound ERM practice. Examples of types of concentrations to be considered (among many) might include undue concentration of insurance risk, counterparty credit risk and specific credit risk exposures (i.e., to certain geographies, industries, asset classes, etc.). A very specific concentration example involving ceded reinsurance catastrophe treaties would consider how best to allocate recoveries to the various legal entities in the group. A similar issue may apply to direct insurance exposures where the group's maximum retained limits are based on net of quota-share pooled or net of intercompany reinsurance<sup>26</sup> results. Exposures that may be overwhelming relative to an entity's size may be easily tolerable after such intercompany reinsurance. Further, one event may impact many different pieces of the group but in different ways across the group – and hence complicate any analysis focused on concentrations.

#### *Group Risk Diversification*

Diversification is generally perceived as a beneficial aspect and can be reflected in calculations of required capital. However, there can be much debate about the quantification of these benefits across groups during periods of stress. Diversification is a natural outcome of the pooling of independent risks but becomes more difficult to assess with risks that become correlated in their tails. Diversification is at least partly related to the issue of capital fungibility between entities or between jurisdictions.

#### *Group Reputation and/or Operational Risk*

There are some sources of risk to the group that may not be subject to reliable quantification. Group reputation risk is an example whereby adverse results or publicity for one member of the group may

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<sup>26</sup> That is, reinsurance between members of the group.

negatively impact the business model for many or all other members of the group. Consideration should be taken of the events that could give rise to a reputation-driven contagion to ensure the effect is properly (not double) counted. Other group risks can include intellectual property and operational risk such as those related to computer systems and cyber risks. (See the *Operational Risk* chapter of the Risk Book for further discussion.)

#### *Group-Level Risk Appetite Statements and Other ERM Controls*

While not precluding separate legal entity views as well as having separate ERM resources at the local level, it is beneficial for their efforts to be coordinated with the group-level ERM function<sup>27</sup> in addition to having a level of controls applied at the group level.

#### *Group-Wide Data Standardization*

Centralized ERM efforts (or group-level coordination of ERM) benefit from some degree of data standardization. Aggregation of risk across entities can be problematic if databases have inconsistent naming conventions or if data for evaluation of risk concentrations are captured within some legal entities but not others. Standardized data also allow for maximizing the use of various risk management tools and other resources. Some groups have a strong “group data language” (GDL), which every entity uses. This makes it possible to add numbers together from different regions knowing that they are consistent, but other groups have issues because, for example, “written premium” can mean different things in different places. Such standardization is of assistance to insurance groups as well as their supervisors. Care is needed to ensure the GDL is sufficiently granular and understood to prevent suppression of key risk characteristics.

#### *Group-Level Stress Tests*

Given the complexity and varying significance of the various types of linkages between members of the insurance group, it is necessary that these linkages be properly considered as part of the group’s risk and capital management, in the evaluation of both group-level solvency and single-entity solvency.

In the event of a serious stress (i.e., one that affects the viability of a member or perhaps is a broad-based stress affecting various members of the group), it is possible that several of the linkages in the group cease to function as expected, and that some linkages are broken. Stress and scenario testing can be effective tools for identifying, analyzing, managing and communicating the risks to the group as a whole, as well as to its member entities.

In some cases, stress tests on a group basis may be difficult to conduct on a legal entity basis, especially if a group has not set up its stress testing models to operate at a granular entity level. This may especially be true where the group or a portion of a group is managed as if it were a single entity (such as via a quota-share pooling agreement or extensive internal reinsurance). Similarly, it may be difficult to aggregate a collection of legal entity stress tests (based on local assumptions and views of risks) into a single stress test result at the group level.<sup>28</sup>

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<sup>27</sup> Areas of group and local ERM coordination include risk tolerance and risk limits. Risk appetite would generally be established at the level at which capital is managed, typically at the group level.

<sup>28</sup> Note that some legal entity stresses have limited impact on other group members, such as that from a local natural disaster that only directly impacts one group entity. While the local stress testing for such events may

Risk management requires an understanding of the behaviours of these linkages according to various adverse scenarios and levels of stress. Some of the possible aspects to be considered may include the following within and across the group:

- Risk positions (e.g., exceeding limits with respect to risk appetite, risk limits);
- Risk concentrations;
- Diversification benefits;
- Fungibility of capital, capital support/guarantees and capital positions;
- Liquidity management and positions;
- Risk management agreements and exposures;
- Service contracts/agreements;
- Contingency and recovery plans;
- Ability to meet rating agency expectations; and
- Ability to meet regulatory requirements and supervisory expectations.

## **7.2 Understanding Supervisory Expectations**

The presence of the various regulatory authorities across a group creates complexity in the operation, governance and management of members of the insurance group and the head of the group, and for the involved supervisors.

As a result, members of the insurance group and its head need to understand the roles, expectations and requirements of their respective involved supervisors.

For example, when business management structures cross legal entity lines, careful management is needed as supervisors necessarily look at the legal entities they supervise, and therefore it is important that persons taking responsibility for the management of each legal entity are clearly identified and that they ensure the entity's interests are appropriately protected when business decisions are made.

To coordinate the group's regulatory initiatives and to provide a focal point of leadership to the group-wide supervisor, the head of the insurance group has ultimate responsibility within the group for meeting the expectations and requirements of the group-wide supervisor.

## **8 Issues for the Supervision/Regulation of Groups**

### **8.1 Importance of the Group-Wide Supervisor**

Given the variety of businesses and geographies in which an insurance group may be involved, as well as the variety of linkages that member entities of the group may have with each other and/or external

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need to be somewhat sophisticated, it may be possible to evaluate the stress to the rest of the group in a more simplified fashion.

(to the group) contractual arrangements, it is important for prudential supervision that there be effective group-wide supervision of an insurance group.

Since insurance groups can involve many supervisors (e.g., insurance supervisors from the various jurisdictions in which the group operates, other sectoral supervisors if the group conducts business in those sectors, market conduct supervisors if they are separate from the prudential insurance supervisors) it is important that “involved supervisors determine the need for a group-wide supervisor and agree on which supervisor will take on that role”.<sup>29</sup> The group-wide supervisor, in cooperation and coordination with involved supervisors, plays a lead role in effective group-wide supervision, including any resolvability issues.

## 8.2 Importance of Supervisory Cooperation and Coordination

Each involved supervisor in an insurance group provides a unique perspective into the group’s operations. Whether their role is as an insurance or banking supervisor, or as a home versus host supervisor for one or more entities in the group, their coordinated and combined efforts are needed to provide effective group-wide supervision. Some components of group-wide supervision<sup>30</sup> include:

- Selection of the group-wide supervisor;
- Formation of a supervisory college;
- Allocation of supervisory responsibilities among the involved supervisors; and
- Recognition and reflection of differing supervisory approaches.

In addition, for larger or more complex groups (e.g., IAIGs), there may be a defined crisis management group, which will typically consist of the supervisors of material insurance entities in the group.

The cooperation and coordination of all involved supervisors, in carrying out their roles as local supervisors and as members of the supervisory college, are important to the effective supervision of the group.

Some of the specific issues involved with group supervision are:

- Determining the scope of the group;
- Supervisory college effectiveness;
- Group-level governance;
- Capital adequacy; and
- Group recovery and resolution.

### *Determining the Scope of the Group*

One of the responsibilities of the involved supervisors of the insurance group is to collectively define the scope of the group to be subject to group-wide supervision.<sup>31</sup> Involved supervisors consult and

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<sup>29</sup> IAIS ICP 25.3; ComFrame requires a group-wide supervisor for an IAIG.

<sup>30</sup> See also IAIS ICPs 3, 23 and 25.

<sup>31</sup> IAIS ICP 23.1.

agree among themselves on the scope of the group to be subject to group-wide supervision to ensure no gaps or unnecessary duplication in regulatory oversight between jurisdictions occur. Consideration of the scope of the group to be subject to group-wide supervision should be undertaken on a case-by-case basis.

This decision may be forced to some extent on the supervisors based on the limits of their authority, yet it should at least consider any entity that can materially impact the solvency of another group member for solo supervision, and the solvency of the insurance group for group supervision.

There are also issues with regard to entities not wholly owned (including joint ventures, minority ownership and those where there is common management). It is not always clear as to when such entities should or should not be included in the group, although the decision will be influenced by the degree to which such entities impact the rest of the group.

Additional issues arise as to whether branches should be viewed as separate entities for the purposes of solvency supervision, or addressed (if at all) as part of the review of the entity they belong to. The decision may be a function of local law and supervisory authority where the branch is located, as well as the extent of ring-fencing of branch assets – whether they are equally available to all policyholders or they are restricted such that they generally support only the branch’s policyholders.

#### *Supervisory College Effectiveness*

A fundamental duty of a supervisory college is for the involved supervisors to work effectively together under the leadership of the group-wide supervisor to supervise the insurance group. Standards and guidance for insurance supervisors relating to supervisory colleges are contained in the IAIS ICPs as well as ComFrame for IAIGs.

One of the challenges in conducting an effective supervisory college is the recognition by involved supervisors that their supervisory approaches are likely to have differences that will need to be addressed during the course of the college. For example, some supervisors may manage on a top-down basis, such that they can force the group head to take actions with respect to subsidiaries (subs) within that jurisdiction (e.g., by forcing movement of capital from sub A to sub B, even if it can endanger sub A’s solvency). Others manage from a bottom-up basis, such that they focus on solvency on a legal-entity-by-legal-entity basis, able to restrict capital flows up to a parent to protect the sub, even if it results in a parent’s insolvency. This can differ by industry sector within a jurisdiction. (Example: U.S. banking regulation is top-down, while U.S. insurance regulation is largely bottom-up.) Difficulties can arise if the approach/authority among the various supervisors for a group is not consistent.

Supervisors benefit from addressing any differences in supervisory approaches in advance, finding a way to cooperate and coordinate their actions in both normal and crisis conditions. This may be addressed via a supervisory college, treaties or other mechanisms. ICPs 23 (Group-wide Supervision) and 25 (Supervisory Cooperation and Coordination) address some of these issues.

#### *Group-Level Governance*

The evaluation of corporate governance is generally a major part of solvency supervision. For stand-alone entities, this requires communication with the senior management and possibly the oversight board of the entity. For group members, there may be a local entity senior management team and a

local oversight board, but those local bodies may or may not be the most relevant bodies with which either the local or group-wide supervisor should communicate.

In some cases, the group will give its entities a relatively free hand to organize themselves, set strategic direction and determine how best to deliver required financial performance. In others there will be a number of criteria set by the group, and the group will maintain a strong influential role both during strategy and business planning phases but also on a regular basis during the year. In the former case (strong local or decentralized control) supervisors may focus their communications on the local bodies, while in the latter case (strong centralized control) supervisors may be more effective by focusing on communications with group management and board.

Some supervisors are also interested in the governance arrangements of group subsidiaries – looking for a balance between group executives providing the link to the group itself but also ensuring there are sufficient independent board members to challenge on issues where the subsidiary's interest and the group's interest may not be fully aligned. A good example of this is the tension that may arise in paying dividends to the group, which might undermine the capital position of the subsidiary.

Under either scenario (decentralized or centralized) group members will need to comply with local legal requirements. This can be challenging, especially where operational structures do not readily align with legal structures.

Operational structures that do not align with legal structures have additional issues with regard to legal entity supervision. This is because any attempt to affect a legal entity's solvency via restrictions or changes in its operations will affect multiple business units. This may limit pinpointed regulation or risk management by entity.

### *Capital Adequacy*

As noted earlier in this chapter, the assessment of the sufficiency of capital at the group level can be complex due to the various linkages among the members of the group as well as the unique risks presented solely due to the formation of the group itself. As a result, capital adequacy at the group level requires the active involvement of members of the supervisory college to develop an understanding of the valuation and stress testing approaches used to examine the capital adequacy of the group at the entity and group level under varying levels and types of stress. ORSA processes and reports are likely to be most helpful in this regard.

### *Group Recovery and Resolution*

Regulatory capital requirements are generally established with multiple action levels; capital below the highest regulatory level generally results in some increased level of supervisor/regulator and/or company action, while capital below the lowest level generally results in a resolution situation in which the supervisor/regulator takes over the entity.<sup>32</sup> In general terms, a supervisor will seek to assume

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<sup>32</sup> This takeover of the entity in a resolution situation does not immediately result in liquidation. The insurance supervisor typically has the authority to first attempt rehabilitation of the entity, allowing certain functions to continue in partial or total runoff mode while such a rehabilitation is considered or attempted. It is typically only after such a rehabilitation is considered or attempted unsuccessfully that an entity is transitioned to orderly runoff or liquidation. Hence in many jurisdictions the insolvency does not result in loss of policy

control of an insurer only after all other avenues of recovery have been pursued with management and while there remain sufficient funds to satisfy its policyholder obligations. Local rules may also dictate at what point any policyholder protection powers become enacted.

In some jurisdictions these regulatory capital requirements exist only at the legal entity level, while in others they exist at both the legal entity and group levels. Regardless, it is possible for a group (or the holding company) to become insolvent while the entity (or entities) within the group remain solvent, and vice versa. A group's insolvency is a separate event from a group member's insolvency. This can be observed in the following three examples:

- In 2008, the AIG group was perceived to be insolvent even while the insurance entity members of the group remained solvent. In that situation, discussions were occurring among the legal entity regulators concerning possible movement of funds to the parent holding company, prior to the U.S. banking regulators determining that the parent needed an immediate bailout.
- A somewhat similar situation occurred in the USA with regard to Monarch Life in the early 1990s.<sup>33</sup> In that instance the parent company went insolvent, and the regulator spent several years working to rehabilitate one of the subsidiary entities (with another of the subsidiary entities not being impaired).
- A third example occurred with Fortis in Europe. The Fortis group contained both banking and insurance operations. In October 2007, Fortis (along with two other partners) acquired portions of another bank just before the GFC. "[T]he large debt created to fund the takeover had depleted the banks' reserves just as the financial crisis of 2007–2010 started. As a result, the Dutch government stepped-in and bailed out Fortis in October 2008."<sup>34</sup> The insurance operations were not the cause of the crisis at Fortis, although the difficulties arising from the group's banking acquisition did change the ownership of the insurance entities.

It is possible for a group to be technically solvent but cash insolvent, due to an inability to access cash or liquid assets held by lower-tier members of the group. This can occur due to issued debt or other cash obligations that are legally only the obligation of the parent entity. Hence the parent of a consolidated group can have assets greater than liabilities, but liquid assets less than immediate parent entity cash demands.

In some jurisdictions the group supervisor can force up-streaming of cash or other liquid assets from the subsidiaries to the parent entity, but this authority generally only extends to the subsidiaries in the same jurisdiction as the parent.

It is also possible for a group to be solvent but one member of a group to be insolvent. This raises the issue of whether a solvent group would/should be allowed to let its insolvent subsidiary remain insolvent, despite having sufficient assets within the group to rectify the situation.

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benefits for many policy beneficiaries, as their obligations are met either via a supervised runoff, transition of the claims to a guaranty fund or transfer of their obligation to a solvent insurer.

<sup>33</sup> [www.gao.gov/assets/230/220977.pdf](http://www.gao.gov/assets/230/220977.pdf)

<sup>34</sup> [http://en.wikipedia.org/wiki/ABN\\_AMRO](http://en.wikipedia.org/wiki/ABN_AMRO), 17 February 2015.

These issues of solvent groups with insolvent members and solvent members with an insolvent parent are some of the reasons why supervisory colleges and crisis management groups are needed. These avenues for regulatory cooperation, as well as group supervision legal frameworks, need to contain mechanisms that address these mixed solvency/insolvency possibilities for groups.

Increasingly, supervisors look for group and consistent solo-level recovery/resolution plans that have anticipated potential crises and examined the tools available to management to deal with the situation.

The degree of interconnectedness among the group members and overall organizational complexity can have significant implications for the orderly runoff or rehabilitation of a group, as one portion of the group may not be viable but may be inseparable (or separable only with great difficulty) from the viable sections of a group. Similarly, one portion of the group may be viable for sale to generate needed capital for the remaining portion of the group, but for those interconnections that complicate such a sale. Complexities and connections that create these problems can include shared resources (e.g., shared accounting systems, shared staff functions, shared investment staff), intra-group guarantees, shared investments and cross-ownerships.

Resolution of insolvencies is covered more fully in that chapter of the IAA Risk Book.

## 9 Issues for Actuaries

Actuaries fulfill a variety of roles within an insurance group, particularly (but not exclusively) within the insurance entities. As described more fully in the *Actuarial Function* chapter of the IAA Risk Book, actuaries may contribute to one or more of the three lines of defence within the entities of an insurance group. In addition, actuaries may be involved with insurance groups through their employment with consulting firms, rating agencies, regulators, etc.

Regardless of their employment, in conducting their work, each actuary should clearly identify their target audience and the scope for their work. In working with insurance groups, actuaries understand and appropriately take into account the various issues outlined in this chapter that are relevant to their work. Even though the focus of the actuary's work may be restricted to a single legal entity of the insurance group, the work may require assumptions regarding services, capital, investment return, etc., provided by other members in the group. Actuaries have the skills to assess the risks to an insurer's operations and to report on things such as expected present value, the nature of risks, their uncertainty, confidence levels, the results of stress testing and scenario analysis – not just for the entity in question but also more broadly for the group, after taking into account the types of group risks described in this chapter.

When participating in work that is group-wide in nature, it is important that the relevant stakeholders have a clear view of the risk issues involved with complex activities and interactions of an insurance group. Actuaries involved with risk management generally, and control functions specifically (i.e., those identified by the IAIS in ICP 8 with respect to actuarial matters and risk management control functions), throughout the insurance group have appropriate regard not only for their entity-specific responsibilities/risks but also for the wider group context/risks within which their work is conducted.



In addition, the head of the group benefits from having adequate access to actuarial expertise (e.g., group-level ORSA). For some insurance groups, supervisors may require the establishment of an actuarial function at the group level.





IAA Risk Book  
Addressing the Consequences of Insurance Groups

Website: See [www.actuaries.org](http://www.actuaries.org) and follow the path to 'Knowledge / Publications / IAA Risk Book'.

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