MFSA

MALTA FINANCIAL SERVICES AUTHORITY

PROPOSED AMENDMENTS TO THE INSURANCE BUSINESS ACT AND INSURANCE INTERMEDIARIES ACT

FEEDBACK STATEMENT ISSUED FURTHER TO INDUSTRY RESPONSES TO MFSA CONSULTATION DOCUMENT

MFSA REF: [11/2014]

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1.0 Background

On the 22nd December 2014, the MFSA issued a consultation document on the proposed amendments to the Insurance Business Act (Cap.403) ("IBA") and Insurance Intermediaries Act (Cap.487) ("IIA").

The purpose of the consultation document was to highlight the main changes to be carried out to the Insurance Business Act (Cap.403) and the consequential amendments to be carried out to the Insurance Intermediaries Act (Cap.487), in order to retain consistency between the two Acts.

Further to the consultation document, the MFSA is issuing a feedback statement on the comments received in relation to the proposed amendments to the IBA and IIA. An outline of the main comments received and the MFSA's position in relation thereto is provided below.

2.0 Main Comments Received on the proposed amendments to the IBA and the MFSA's position

2.1 Power to issue Insurance Rules

Industry comment: The insurance industry pointed out that some of the draft articles of the proposed amendments give the power to the MFSA to issue Insurance Rules in relation to matters that are addressed in the Commission Delegated Regulation (EU) 2015/35 of 10 October 2014 supplementing Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) published on the 17th January 2015.

MFSA's Position: The MFSA would like to clarify that the Insurance Rules which will be issued by the MFSA under the IBA will transpose the provisions of the Solvency II Directive which have not been included in the main text of the proposed IBA. It is not the intention of the MFSA to transpose the Commission Delegated Regulation, since this is directly applicable to Member States and does not require transposition into national law.

2.2 Proposed article 2 - Definitions

2.2.1 Definition of "function"

Industry Comment: An industry participant pointed out that Article 13(29) of the Directive provides a definition of "function" within a system of governance, which is defined as "*an internal capacity to undertake practical tasks; a system of governance includes the risk management function, the compliance function, the internal audit function and the actuarial function*". It was suggested to transpose the Solvency II definition of "function" in article 2(1) of the revised IBA, which definition would substitute the current definition of "functions" in article 2(1) of the current IBA.

MFSA's Position:

The MFSA is of the view that the definition of "functions", as contained in the current IBA, is to be distinguished from the definition of "function" under Article 13(29) of the Solvency II Directive, which is defined in the context of systems of governance within the Solvency II framework. Moreover, the word "functions" is used various times in the IBA, and is not linked to the functions related to the systems of governance. Therefore, the MFSA is of the view that the definition of "function" as defined in Article 13(29) of the Solvency II Directive should not be transposed in article 2(1) of the proposed IBA, as this will create uncertainty as to the interpretation of this term. The MFSA will thus retain the definition of "functions" as found in the current IBA and will transpose the definition "function", as defined in Article 13(29) of the Solvency II Directive in the Insurance Rules to be issued under the IBA in which Articles 41 to 50 of the said Directive will be transposed.

2.2.2 Definition of "outsourcing"

Industry Comment: Clarification is sought as to whether the new definition of "outsourcing", is to apply only to outsourcing of key/critical functions, in accordance with article 49 of the Solvency II Directive. It was also suggested that the interpretation of "*a process, a service or an activity [...] which would otherwise be performed by the authorised insurance or reinsurance undertaking*" be interpreted in a restrictive manner so that such process or service should be pertinent to the business of insurance or reinsurance and exclude matters of an administrative nature.

MFSA's Position: The MFSA will retain this definition of "outsourcing" as defined in the Solvency II Directive. As has been the practice, it will approve the outsourcing of key critical functions. Outsourcing of administrative nature, as has been the case to date, will not require the prior approval of the MFSA. The MFSA intends to clarify this in Insurance Rules to be issued under the IBA.

2.2.3 Definition of "reinsurance"

Industry Comment: The respondent maintained that the amended definition of "reinsurance" could be interpreted to limit reinsurance inwards business to risks ceded by insurance undertakings authorised under the IBA only and excludes other risks ceded by EU/EEA or third country authorised insurance undertakings.

MFSA's Position: The MFSA acknowledges these comments and amended the proposed definition of "reinsurance" in the IBA as it was too restrictive.

2.3 Proposed article 7 (3) – Authorisation for carrying on business of insurance

Industry Comment: A respondent requested clarification as to whether, following the amendments carried out to article 7 of the IBA, the general good provisions of the Member States, applicable after passporting, will be applicable with the introduction of Solvency II for those companies which are currently passporting into other Member States.

MFSA's Position: The MFSA would like to point out that article 7(3) of the IBA transposes Article 15(1) of the Solvency II Directive. This provision clarifies that an authorisation issued under the article 7 entitles an undertaking whose head office is in Malta to carry on business of insurance in a Member State or EEA State. In such cases, the supervisory authority of the host Member State can still impose general good provisions, which are to be adhered to by undertakings carrying on business in other Member States.

2.4 Proposed article 8 – Authorisation requirements

2.4.1 Article 8(1)

Industry Comment: Reference was made to the amendments carried out to article 8 of the IBA. A number of respondents noted that that objects clause of undertakings, which intend to carry on business not restricted to reinsurance, in terms of article 8(1)(b)(i) "*is limited to business of insurance and operations arising directly therefrom, to the exclusion of all other commercial business"*. Whilst in the case of an undertaking which intends to carry on business restricted to reinsurance, in article 8 (1)(b)(ii) the objects are extended, so that :*"this may include a holding company function and activities with respect to financial sector activities within the meaning of Article 2(8) of Directive 20002/87/EC (...)"*. Clarification was sought as to why this is being included for reinsurers only.

MFSA's Position: The MFSA would like to point out that Article 8 of the IBA transposes Article 18(1) of the Solvency II Directive. It is to be clarified that Article 8(1)(b)(ii) applies only to authorised reinsurance undertakings. Reference is made to Recital (13) of the Solvency II Directive which provides an explanation of the objects clause for reinsurance undertakings. This Recital states that reinsurance undertakings should limit their objects to the business of reinsurance and related operations and should not prevent a reinsurance undertaking from pursuing activities such as the provision of statistical or actuarial advice, risk analysis or research for its clients. It may also include a holding company function and activities with respect to financial sector activities within the meaning of Article 2(8) of Directive 2002/87/EC. In any event, that requirement does not allow the pursuit of unrelated banking and financial activities. In so far as authorised insurance undertakings are concerned, the objects are to be limited to business of insurance and operations arising directly therefrom, to the exclusion of all other commercial business, as stated in Article 18(1)(a) of the Solvency II Directive.

2.4.2 Article 8(2)

Industry Comment: The insurance industry requested clarification as to the approach to be adopted by the MFSA, where an undertaking intends to extend its business to another class of business or intends to extend an authorisation which covers only some of the risks pertaining to one class of business. The industry sought clarification as to whether the submission of a scheme of operations is required if the company is already licensed in a particular class but wishes to market a new product which is captured by such class.

MFSA's Position: Article 8(2) of the IBA transposes Article 18(2) of the Solvency II Directive and is without prejudice to the article 5 of the IBA. The MFSA would like to clarify that, if the new product is within the same class of insurance for which the company is already authorised, the insurance undertaking is not required to approach the MFSA as per current practice. However, if the new product entails a material change in the scheme of operations submitted to the MFSA by the undertaking, this would necessitate a notification to the MFSA.

2.4.3 Article 8(4)

Industry Comment: An industry respondent pointed out that since the proposed article 8(4) is intended to transpose the last paragraph of Article 19 of the Solvency II Directive, article 8 (4) should refer to subarticle (3)(a) only.

MFSA's Position: The MFSA amended the proposed subarticle to reflect these comments.

2.5 Proposed article 9 – Combination of long term business and general business

Industry Comment: The insurance industry expressed concern that the possibility which currently exists under the current IBA, for an insurance undertaking authorised to write general business of insurance to have its authorisation extended to write long term reinsurance, was removed. The proposed draft IBA seems to exclude this possibility since the proposed draft article 9 transposes Article 73(2) of the Solvency II Directive which does not cater for this possibility. According to respondents, this does not appear to be driven by Solvency II and is restricting the options for authorisation with a combination of long term business and general business. This would be particularly disadvantageous for the captive industry.

MFSA's Position:

Following representations by the market on article 9, the MFSA has agreed to reintroduce the possibility of an authorised insurance undertaking authorised to write general business insurance to have its authorisation extended to write long-term reinsurance notwithstanding that it is not reflected in the Solvency II Directive. In this respect, the MFSA considers that this amendment reflects recital (9) of the Solvency II Directive, which was given a wide interpretation and which provides that: *"The Directives repealed by this Directive do not lay down any rules in respect of the scope of reinsurance activities that an insurance undertaking may be authorised to pursue. It is for the Member States to decide to lay down any rules in that regard."*

2.6 Proposed article 18E - Technical Provisions

Industry Comment: A number of respondents commented on the new proposed requirement in subarticle (6) for insurance undertakings to maintain "*a special register of the assets used to cover technical provisions calculated and invested in accordance with Insurance Rules*." The proposed subarticle transposes Article 276(1) of the Solvency II Directive, which relates to the

treatment of insurance claims in the event of winding-up proceedings. It was maintained that since under the Solvency II, undertakings are required to comply with the Prudent Person Principle in their investment strategy, and are required to hold sufficient capital to cover any market risk, including equity, interest rate, counterparty, concentration and currency risk, as the case may be, this requirement is to be removed.

MFSA's Position: Following representations from the market this requirement was removed. Article 276 of the Solvency II Directive, requiring Member States to maintain a special register, provides that this requirement applies for those Member States who have chosen option 1 (a) of Article 275 of the Solvency II Directive where insurance claims take precedence over other claims against the insureds with regards to assets representing technical provisions. In Malta, insurance claims take precedence over any other claim against an insurance undertaking with regard to the whole of the assets of such undertaking, which reflects option 1(b) of Article 275 of the Solvency II Directive. However, the MFSA expects that the details of the assets representing the technical provisions are readily available and updated by undertakings.

2.7 Proposed article 18G – Custody of assets required to be maintained in Malta

Industry Comment*:* A respondent requested clarification as to the interpretation of subarticle (1) whereby undertakings are required to maintain assets in Malta, subject to subarticles (2) and (3). It was pointed out that subarticles (2) and (3) allow the MFSA discretion, in that assets could be held in countries other than Malta if these countries satisfy the MFSA. The respondent is of the view that given the expanding international insurance market in Malta companies will require the comfort of knowing in advance that their investments can be placed in EU /EEA/ OECD countries.

MFSA's Position: The MFSA would like to point out that the purpose of this provision is to transpose Article 162(2)(e) of the Solvency II Directive. The regulations that will be issued under this article, will clarify that this requirement will apply to third country insurance or reinsurance undertakings carrying out servicing or run-off of business of insurance operations in Malta.

2.8 Proposed article 20 – Audited Financial Statements

2.8.1 ***Industry Comment:*** The insurance industry commented on the change in the time frame for the submission of the audited annual financial statements from six months to four months. It was pointed out that the Solvency II Directive does not specifically mention any timelines for the filing of such audited accounts. Reference was made to section 8 (Guideline 35) of EIOPA's "Guidelines on Submission of information to National Competent Authorities" which provide that the deadline for submission of supervisory reporting is that of 22 weeks, which will be reduced to 18 weeks for the financial year ending 2016. Thus, the industry suggests to have audited accounts to be filed with the MFSA within timelines that adjust gradually over time, starting with five months after the close of the financial year of the undertaking, reducing it to four months for the financial year ending 2016. The industry also

asked whether it would be possible to synchronise the time-frames within which both the audited financial statements and the Solvency II reporting are required.

MFSA's Position: Following the representations of the market, the MFSA removed the time period of four months from the IBA and will include the period within which the audited financial statements are to be submitted in an Insurance Rule, rather than listing the different transitional time-periods for submission of the annual audited financial statements as found in the Solvency II Directive, in the main Act.

2.8.2 ***Industry Comment:*** An industry respondent requested clarification on the manner on which audited financial statements will be drawn up and published and the fact that this will be specified in an Insurance Rule. It was queried whether these will constitute additional requirements to the existing ones.

MFSA's Position: The MFSA would like to clarify that the Insurance Business (Companies Accounts) Regulations [S.L.403.07] will be repealed, due to the fact that in Malta all companies are required by the Companies Act (Cap.386) to prepare their financial statements in line with IASs and IFRSs as adopted by the EU. Since the Commission Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards and the Commission Regulation (EC) No 1126/2008 of 3 November 2008 adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council, adopt all IASs and IFRSs as part of EU legislation, the Companies Accounts Regulations will be repealed. In so far as the publication of the audited financial statements is concerned, this requirement will be set out in an Insurance Rule.

2.9 Proposed articles 22 and 23 – the approved actuary

Industry Comment: Some respondents commented that since the Solvency II Directive is a maximum harmonisation Directive, the appointment of "an approved actuary in the case of undertakings with head office in Malta carrying on long term with-profits business" is incompatible with the Directive and potentially discriminatory because it applies only to "undertakings with head office in Malta". Others agreed on retaining the appointed actuary regime, however requiring clarification on the role of the appointed actuary. It was also argued that the requirement for the approved actuary to be "independent from the authorised undertaking appointing him", is incompatible with article 18 I of the IBA.

MFSA's Position:

Reference was made to paragraph 2.17 of the Final Report on Guidelines on system of governance, published by EIOPA on 28th January 2015, which specifically makes reference to the appointed actuary. The said report states that *"While the Solvency II Directive is to a large extent about maximum harmonisation, this is not the case for the whole Directive. There are still a number of areas where Member States may keep or introduce stricter requirements as and where appropriate."* Furthermore, Annex I of the said report provides that since the "responsible/appointed actuary" is not foreseen by Solvency II, it is up to the supervisory

authorities concerned to decide on whether to keep the "responsible/appointed actuary" or not, and how it relates to the actuarial function. This further strengthens the MFSA's position that retaining the appointed actuary is not incompatible with the Solvency II Directive. Although the role of the appointed actuary can be retained for all undertakings carrying on all classes of long term business of insurance, the MFSA retained its original position as stated in the Consultation paper to limit the appointment of the appointed actuary to authorised insurance undertakings carrying on long term with-profits business in terms of classes I and III, as specified in the Second Schedule to the Act.

In so far as the issue of independence of the appointed actuary is concerned, the MFSA removed the requirement of independence of the approved actuary and replaced it with the concept of conflict of interests, so that a person carrying out such a role does not hold a role or perform a function on behalf of the undertaking which could give rise to a significant conflict of interest.

2.10 Proposed article 30 – Power of the MFSA to examine the affairs of authorised undertakings and service providers

2.10.1 Article 30(6)

Industry Comment: Records are kept in the language of the jurisdiction where the activities are performed. The requirement to provide information to the MFSA in either the English or Maltese language is considered excessively burdensome by the market.

MFSA's Position: The MFSA notes this suggestion, but is of the view that this requirement is to be maintained. From a supervisory perspective, it is pointless for the MFSA to receive information which it is unable to assess and evaluate as it is being provided in a language other than the official language. The Maltese and the English languages are the official languages of Malta.

2.10.2 Article 30(7)

(a) Industry Comment: An industry respondent noted that the scope of this section is excessively wide and far-reaching and covers activities that would not normally be regulated except because they have been outsourced. In addition, the respondents requested clarity on the extent of the words in subarticle (7): "rendered applicable also to outsourced activities of such undertakings." It was also noted that the indicated applicable Parts of the IBA in article 30 (11) are very broad in scope, covering also aspects on prudential matters such as setting capital add-ons etc.

***MFSA's Position*:** This article reflects the provisions of Article 38(2) Solvency II which also makes reference to non-supervised activity. The MFSA noted the comments above and in this respect amended the proposed article 30(11) so that the powers available to the MFSA with

regard to the outsourced activities of authorised insurance and reinsurance undertakings are those listed in articles 29 to 31A of the Act.

(b) Industry Comment: It was pointed out that article 30(7) of the proposed Act, transposing Article 38(2) of the Directive, provides that, where an authorised insurance undertaking outsources a function or activity to a service provider located in a Member State or EEA State other than Malta, the competent authority shall inform the appropriate authority of the Member State or EEA State of the service provider prior to conducting on site-inspection at the premises of the service provider. However, subarticle (7) applies only to a service provider located in a Member State or EEA State other than Malta. Thus, it was suggested to amend article 30, so that the MFSA has the power to examine the affairs of service providers located in Malta.

MFSA's Position: The MFSA noted the comments above and in this respect amended the proposed article 30(7) to clarify that the MFSA also has the power to examine the affairs of service providers located in Malta. As is the current practice, all outsourcing agreements should provide for access by the MFSA to relevant data held by the outsourcing service provider contractor and the right for the MFSA to conduct on-site inspections at the premises of an outsourcing service provider should be incorporated in the outsourcing agreements.

(c) Industry Comment: An industry participant noted that changes will need to be applied with Solvency II allowing the MFSA to conduct on-site inspections at the premises of the outsourced party and queried as to whether these powers will be subject to specific local rules applicable in the country of the outsourced party, particularly if located outside an EU Member State.

***MFSA's Position*:** The MFSA noted the comments above and in this respect has added a new article 30(12) which provides that article 30(7) of the IBA will apply even where the service provider is located in a country outside Malta, which is not a Member State or EEA State.

2.11 Proposed article 36A – Transfer of portfolio to an authorised insurance or reinsurance undertaking

Industry Comment: The insurance industry commented on the proposed new requirement that where the transferee intends to take over a portfolio transfer, it is required to notify the MFSA and seek its consent. A respondent is of the view that the requirement for MFSA's consent in writing for each transfer of portfolio is burdensome and will result in a longer process, to the detriment of particular undertakings where such transactions are at the core of the business model. It was also pointed out that the *General Protocol relating to the collaboration of the insurance supervisory authorities of the Member States of the European Union* does not contain such a requirement but contains a procedure with which the competent authorities of the home Member State and host Member State are required to comply with.

MFSA's Position: The MFSA is of the view that it should be notified of such a transfer by the transferee authorised by the MFSA. An incoming portfolio of business may give rise to

additional capital requirements since it may impact the solvency position of the transferee and/ or necessitate that approvals are obtained for a new class of business. Currently, in practice, this is already done since article 43 of the current IBA requires licence holders to notify in writing the MFSA of any material changes in relation to information or documents submitted to the MFSA.

In so far as the General Protocol referred to above is concerned, it lays down the procedure to be followed between the competent authorities in the case of a transfer of portfolio so that the competent authority of the accepting undertaking is to approve the transfer within 3 months and give approval to the competent authority of the transferring undertaking.

2.12 Proposed article 58 - Appeals

Industry Comment: It was suggested that power of the MFSA to set a capital add-on is also added as one of the grounds of appeals by undertakings.

MFSA's Position: Solvency II Directive does not provide for the possibility of an appeal with respect to the imposition of capital add-on and therefore will not be added as a possible ground of appeal. The MFSA would like to highlight that the imposition of capital add-on is a measure used in exceptional circumstances as stated in Article 37 of the Solvency II Directive.

2.13 Legal Notices to be issued under the Insurance Business Act

The MFSA is presently reviewing the current regulations issued under the IBA to bring them in line with the requirements of the Solvency II Directive. The draft regulations as well as the Insurance Rules will be issued for Consultation during 2015.

3.0 Insurance Intermediaries Act

In so far as the proposed amendments to the IIA are concered, no issues were raised by the insurance market.

Contacts

Any queries or requests for clarifications in respect of the above should be addressed by email on ipsu@mfsa.com.mt.

Communications Unit
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