

## **Consultation Procedure**

### **Proposals for Legal Notices / Ministerial Regulations and for new laws and amendments to existing laws**

#### ***Explanatory Note***

The documents circulated by the MFSA for the purpose of consultation are in draft form and consist of proposals. Accordingly these proposals are not binding and are subject to changes and revisions following representations received not only from licence-holders and other involved parties, but also following the necessary review and vetting by the Office of the Attorney General and the relevant Minister to whom the MFSA is required by law to provide advice on financial services matters. It is important that persons involved in the consultation bear these considerations in mind.

In the case of primary legislation in particular, Bills may and do undergo revisions during the Parliamentary stages.

This consultation is also being exercised at the request and on behalf of the Ministry of Finance.

## **Note for Consultation**

### **(EU Reinsurance Directive)**

#### **1. Purpose**

- 1.1 The MFSA is proposing to carry out a series of amendments to various sets of legislation and Insurance Directives/Rules as part of the exercise of transposing into Maltese law EU Directive 2005/68/EC of the European Parliament and of the Council of 16 November 2005 on reinsurance and amending Council Directives 73/239/EEC, 92/49/EEC as well as Directives 98/78/EC and 2002/83/EC (“the Reinsurance Directive”). In this respect, we are attaching the Insurance Business (Assets and Liabilities) Regulations, 2007, and the Insurance Rule 1 of 2007, in draft form, in order to seek consultation prior to implementation. Comments are to be provided to the MFSA in writing by not later than **Monday 25<sup>th</sup> June 2007**.
- 1.2 The most significant changes relate to the Insurance Business (Insurers’ Assets and Liabilities) Regulations, 2004 (“the 2004 Regulations”), discussed under section 2 below. Other subsidiary legislation proposed to be amended include the Insurance Business (Supplementary Supervision of Insurance Undertakings in an Insurance Group) Regulations, 2004, discussed under section 3 below, the European Passport Rights for Insurance Undertakings Regulations, 2004, discussed under section 5 below and the Insurance Business (Companies Carrying on Business of Affiliated Insurance) Regulations, 2003, discussed in section 6 below. The MFSA is also proposing to amend Insurance Rule 1 of 2007 - Own Funds of Companies Carrying on Business of Insurance, discussed in section 4 below, Insurance Directive 21 of 2003 - Business of Affiliated Insurance, also discussed in section 6 below. Finally, the MFSA is proposing to carry out some minor amendments to Insurance Rule 6 of 2007 - Schemes of Operations Relating to Business of Insurance to be Carried on in the Case of Insurers, referred to in section 7 below.

#### **2. The Insurance Business (Assets and Liabilities) Regulations, 2007 (“the Regulations”)**

Whilst in the process of amending the 2004 Regulations to transpose the Reinsurance Directive, the MFSA is also proposing to carry out certain other amendments, in line with the respective EU Insurance Directives.

Discussed below are the most significant changes proposed vis-à-vis the Regulations:

##### **2.1 Regulation 2 – Interpretations**

- 2.1.1 The MFSA is proposing to carry out some amendments to certain interpretations in order to be able to effectively transpose the provisions of the

Reinsurance Directive. For the purposes of the Regulations the most significant changes are the following:

- an “insurer” means a company having authorisation to carry on business of direct insurance (i.e. a company authorised under the Act to carry on either solely direct insurance business, or both direct and reinsurance business);
- a “pure reinsurer” means a company having authorisation to carry on business restricted to reinsurance; and
- an “insurance holding company” means a parent undertaking, the main business of which is to acquire or hold participations in subsidiary undertakings, where those subsidiary undertakings are exclusively or mainly insurance or reinsurance undertakings, whether authorised in an EEA state or not, at least one of such subsidiary undertakings being an insurer or pure reinsurer, and which is not a mixed financial holding company as is assigned to it in regulation 2 of the Financial Conglomerates Regulations 2004.

## **2.2 Regulation 9 – Determination of margin of solvency**

2.2.1 The MFSA is proposing that, in terms of the Reinsurance Directive, the required margin of solvency for non-life reinsurance activities be computed on the basis of the calculation for the required margin of solvency for non-life business (i.e. in terms of the Second and Third Schedules to the Regulations).

2.2.2 On the other hand, in line with the Reinsurance Directive, the MFSA is proposing that the calculation of the required margin of solvency for life reinsurance activities (subject to reinsurance activities exceeding a certain threshold (as specified in regulation 9(2)(b)) of the undertaking’s operation in the case of a company authorised to carry on both direct and reinsurance business) be computed also on the basis of the calculation for the required margin of solvency for non-life business (i.e. in terms of the Second Schedule and Third Schedules to the Regulations). However, the MFSA is also proposing that for reinsurance classes of business covered by Article 2(1)(a) of Directive 2002/83/EC linked to investment funds or participating contracts and for the operations referred to in Article 2(1)(b), 2(2)(b), (c), (d) and (e) of Directive 2002/83/EC (*vide Annex I*), the required solvency margin may, upon application to the MFSA, be determined in accordance with the calculation for the required margin of solvency for life business (i.e. in terms of the First Schedule to the Regulations). These calculation bases, pursuant to the respective articles in the Reinsurance Directive, are reflected in regulation 9 to the Regulations.

2.2.3 It is being proposed that undertakings be given this option vis-à-vis life reinsurance activities since, in contrast to life protection business, for investment and annuity business, the non-life solvency rules would, in general, be more onerous than the life requirements. These rules are also less risk sensitive and so less appropriate as a measure of capital requirements. This is particularly likely to be the case for large single premium annuity contracts, where there is a large premium in the first year but no further premiums in

later years. This is because the non-life test is calculated on the basis of premiums and claims over a specified period, which are not appropriate proxies for the risk under this type of contract. For these reasons, the MFSA intends to allow the possibility to maintain the existing life solvency requirements in respect of the risks referred to in the above paragraph.

### **2.3 Regulation 10 - Valuation**

- 2.3.1 In terms of the 2004 Regulations and Insurance Rule 1 of 2007 - Own Funds of Companies Carrying on Business of Insurance, the components making up the own funds of an undertaking are different from the components covering its available margin of solvency.
- 2.3.2 The MFSA is proposing to remove these differences and consequentially it is proposed to amend regulation 10. This amendment will bring the Regulations with respect to the components making up the available solvency margin in line with the provisions of EU Directive 73/239/EEC and EU Directive 2002/83/EC, and in line with the provisions of Insurance Rule 1 of 2007.

### **2.4 Part VIII - Equalisation reserves**

Under Part VIII, the 2004 Regulations distinguish between two types of equalisation reserves, namely: (1) equalisation on business other than credit insurance business; and (2) equalisation on credit insurance business.

#### **2.4.1 Equalisation on business other than credit insurance business**

The equalisation reserve on business, other than credit insurance business had been adopted locally notwithstanding the fact that this was not a requirement in terms of the EU Insurance Directives. The requirement to establish an equalisation reserve on business other than credit insurance business, applies to insurers underwriting property business and consequential loss attributable thereto, marine business, aviation business, nuclear risk business, subject to a number of conditions. The MFSA is proposing that the obligation to maintain equalisation reserves in respect of the non-credit business be removed. As a result, the Sixth and Seventh Schedules will be removed from the 2004 Regulations. As a prudent measure, insurers would be expected to capitalise these current equalisation reserves rather than distributing them.

#### **2.4.2 Credit insurance equalisation reserve**

Under Title III of Part VIII, the Regulations require that an insurer authorised to carry on credit insurance business maintains a credit insurance equalisation reserve. The credit insurance equalisation reserve is a requirement in terms of EU Directive 73/239/EEC, and is also applicable to pure reinsurers in terms of the Reinsurance Directive. Thus, it is being proposed that the existing conditions applicable to insurers to maintain a credit insurance equalisation reserve will also be applied to pure reinsurers.

## **2.5 Assets covering liabilities other than technical provisions and the margin of solvency for insurers**

- 2.5.1 In terms of the current regulation 50 of the 2004 Regulations, assets covering both the liabilities as well as the margin of solvency of an insurer are subjected to valuation rules (in terms of Part IX of the Regulations) and exposure limits (in terms of the current Ninth Schedule of the 2004 Regulations, renumbered as the Seventh Schedule). The MFSA is proposing to carry out amendments to the effect that only those assets covering technical provisions will be subjected to the valuation rules and exposure limits. As a result, liabilities other than technical provisions and the margin of solvency will be relieved from the requirement to be covered by assets which have been subjected to valuation rules and admissibility limits. Accordingly, Part IX will be amended to reflect this change. This proposal is in line with the provisions of EU Directive 73/239/EC (the Non-Life Directive) and EU Directive 2002/83/EC (the Life Assurance Directive).

The MFSA would point out that the proposed measure noted in the paragraph above is a temporary measure until the Solvency II regime is implemented. Under the said regime it is expected that companies will be required to adopt a balance sheet approach (i.e. all the assets of the company will be taken into consideration, and not just the assets covering the technical provisions).

## **2.6 Asset valuation, relevant limits and currency matching rules in respect of pure reinsurers**

- 2.6.1 In order to safeguard policyholders' interests it is necessary to have strict asset valuation rules, admissibility limits and currency matching rules for insurers. However, in the MFSA's opinion, these quantitative limits and rules need not be applied to pure reinsurers since these would place unnecessary constraints on the latter's investment strategies. This could ultimately impact on higher reinsurance premiums as a result of excessive capital requirements.
- 2.6.2 In this regard, the MFSA is proposing that the asset valuation rules, the admissibility limits and currency matching rules applicable for insurers are not applied to pure reinsurers, except for the regulations addressing the valuation of shares in group undertakings (*the newly renumbered regulation 43*) and the valuation of debts due or to become due from group undertakings (*the newly renumbered regulation 44*). The regulations addressing the valuation of shares in group undertakings and the valuation of debts due or to become due from group undertakings will still have to be applied since the group undertakings would still be required to meet their respective required margin of solvency in terms of the applicable legislation.
- 2.6.3 Notwithstanding the above exemptions, the MFSA is proposing that, in line with the requirements of the Reinsurance Directive the 'prudent person' investment principles be adopted. Hence, the rules will require that a pure reinsurer ensures that the assets covering its technical provisions (in line with the new proposed approach for insurers, referred to in section 2.5 above) are diversified and adequately spread, and allow the reinsurer to respond

adequately to changing economic circumstances. Asset investments shall also take account of the type of business carried out by the undertaking, in particular the nature, amount and duration of the expected claims payments, in such a way as to secure the sufficiency, liquidity, security, quality, profitability and matching of the undertaking's investments (*proposed regulation 55 refers*)

## **2.7 Part X - Determination of liabilities**

- 2.7.1 In line with the proposals in relation to the asset valuation rules referred to in section 2.6 above, the MFSA is proposing that the rules for determination of liabilities applicable for insurers are not applied to pure reinsurers, except vis-à-vis the determination of provisions for related undertakings where these register deficits in meeting their respective required solvency margins in terms of the applicable legislation. The MFSA is proposing that pure reinsurers' other liabilities (i.e. liabilities other than provisions for related undertakings) be determined in accordance with rules set out in the Insurance Business (Companies Accounts) Regulations, 2000 (*proposed regulations 76 and 77 refer*).

## **2.8 Part XI – Parent undertaking solvency calculation**

- 2.8.1 The MFSA is proposing that, as a result of the amendments introduced by EU Directive 98/78/EC on the supplementary supervision of insurance and reinsurance undertakings in an insurance or reinsurance group by means of the Reinsurance Directive, the parent undertaking solvency calculation be amended to take into account both insurers and pure reinsurers (and not just insurers) authorised under the Act which are subsidiaries of other insurance or reinsurance undertakings (i.e. insurance or reinsurance companies whether or not authorised in an EEA state), or insurance holding companies, which are not themselves the subsidiaries of other insurance or reinsurance undertakings, or insurance holding companies.

## **2.9 Fourth Schedule - Minimum guarantee fund**

- 2.9.1 In consequence of the Reinsurance Directive, the MFSA is proposing the following changes to the minimum guarantee fund, addressed in the Fourth Schedule to the Regulations:
- The minimum guarantee fund in respect of affiliated pure reinsurers be set at EUR1,000,000, while the minimum guarantee fund in respect of non-affiliated pure reinsurers be set at EUR3,000,000. Such amounts represent the floor for pure reinsurers in terms of the Reinsurance Directive. Under the 2004 Regulations, there is no minimum guarantee fund for pure reinsurers, irrespective of whether the companies are affiliated or not; and
  - In the case of non-life insurers carrying on both direct and reinsurance business, and where the reinsurance activities exceed a stipulated threshold (paragraph 4 of the said Schedule refers) vis-à-vis the insurers' entire operations, the minimum guarantee fund shall read EUR3,000,000.

**3. Proposed amendments to the Insurance Business (Supplementary Supervision of Insurance Undertakings in an Insurance Group) Regulations, 2004**

3.1 The MFSA is proposing that, as a result of the changes introduced by EU Directive 98/78/EC on the supplementary supervision of insurance and reinsurance undertakings in an insurance or reinsurance group by means of the Reinsurance Directive, the undertakings falling within the scope of supplementary supervision will include:

- Every insurer or pure reinsurer whose head office is in Malta which is a participating undertaking in at least one insurance or reinsurance undertaking, whether authorised in an EEA state or not;
- Every insurer or pure reinsurer whose head office is in Malta the parent undertaking of which is a mixed-activity insurance holding company; and
- Every insurer or pure reinsurer whose head office is in Malta the parent undertaking of which is a parent undertaking, other than an insurance or reinsurance undertaking, whether authorised in an EEA state or not, an insurance holding company or a mixed financial holding company in terms of regulation 2 of the Financial Conglomerates Regulations, which includes at least one insurer or pure reinsurer among its subsidiary undertakings.

3.2 For the purposes of the above, a “mixed-activity insurance holding company” means a parent undertaking, other than an insurance or reinsurance undertaking, whether authorised in an EEA state or not, an insurance holding company or a mixed financial holding company in terms of regulation 2 of the Financial Conglomerates Regulations, 2004, which includes at least one insurer or pure reinsurer among its subsidiary undertakings.

**4. Proposed amendments to Insurance Rule 1 of 2007 - Own Funds of Companies Carrying on Business of Insurance**

4.1 The MFSA is proposing to reissue Insurance Rule 1 of 2007 - Own Funds of Companies Carrying on Business of Insurance, in particular, to reflect the amounts of the minimum guarantee fund as contained in the Reinsurance Directive.

**5. Proposed amendments to the European Passport Rights for Insurance Undertakings Regulations, 2004**

5.1 In order to cater for rights of reinsurance undertakings authorised in other EEA states to passport into Malta under the freedom of establishment or freedom of services, the MFSA is proposing to amend the European Passport Rights for Insurance Undertakings Regulations, 2004 to the effect that it will be granted the power to intervene whenever such an undertaking does not

comply with the relevant legal provisions. Moreover, the MFSA shall have the power to carry out on-site verification at the Malta branch of the reinsurance undertaking authorised in another EEA state after having first informed the competent authority of the home member state.

**6. Insurance Business (Companies Carrying on Business of Affiliated Insurance) Regulations, 2003 and Insurance Directive 21 of 2003 – Business of Affiliated Insurance**

- 6.1 The MFSA is proposing to amend the above mentioned legislation to introduce the concept of ‘captive reinsurance undertakings’ as defined in the Reinsurance Directive.

**7. Insurance Rule 6 of 2007 - Schemes of Operations Relating to Business of Insurance to be Carried on in the Case of Insurers**

- 7.1 Whilst in the process of amending the various sets of regulations and Insurance Rule referred to above, the MFSA is taking the opportunity to carry out some minor amendments to Insurance Rule 6 of 2007 - Schemes of Operations Relating to Business of Insurance to be Carried on in the Case of Insurers.

**11<sup>th</sup> May, 2007**



## **ANNEX I**

### **Directive 2002/83/EC of the European Parliament and of the Council of 5 November 2005 concerning life assurance**

#### *Article 2*

##### **Scope**

This Directive concerns the taking-up and pursuit of the self-employed activity of direct insurance carried on by undertakings which are established in a Member State or wish to become established there in the form of the activities defined below:

1. the following kinds of assurance where they are on a contractual basis:
  - (a) life assurance, that is to say, the class of assurance which comprises, in particular, assurance on survival to a stipulated age only, assurance on death only, assurance on survival to a stipulated age or on earlier death, life assurance with return of premiums, marriage assurance, birth assurance;
  - (b) annuities;
  - (c) supplementary insurance carried on by life assurance undertakings, that is to say, in particular, insurance against personal injury including incapacity for employment, insurance against death resulting from an accident and insurance against disability resulting from an accident or sickness, where these various kinds of insurance are underwritten in addition to life assurance;
  - (d) the type of insurance existing in Ireland and the United Kingdom known as permanent health insurance not subject to cancellation;
2. the following operations, where they are on a contractual basis, in so far as they are subject to supervision by the administrative authorities responsible for the supervision of private insurance:
  - (a) tontines whereby associations of subscribers are set up with a view to jointly capitalising their contributions and subsequently distributing the assets thus accumulated among the survivors or among the beneficiaries of the deceased;
  - (b) capital redemption operations based on actuarial calculation whereby, in return for single or periodic payments agreed in advance, commitments of specified duration and amount are undertaken;
  - (c) management of group pension funds, i.e. operations consisting, for the undertaking concerned, in managing the investments, and in particular the assets representing the reserves of bodies that effect payments on death or survival or in the event of discontinuance or curtailment of activity;
  - (d) the operations referred to in (c) where they are accompanied by insurance covering either conservation of capital or payment of a minimum interest;
  - (e) the operations carried out by assurance undertakings such as those referred to in Chapter 1, Title 4 of Book IV of the French 'Code des assurances'.