



**Practice Direction Number 2 of 2006,
Issued under section 40 of the Financial Services Commission Act, 2001.**

Investment Policy for Captive Insurance Companies

1 Introduction

- 1.1 The Insurance Act, 1994 provides that an insurance licence-holder must satisfy the Commission that it has available to it the knowledge and expertise necessary to carry on insurance business in a competent manner.
- 1.2 This Practice Direction serves to promote sound and prudent investment management practices for a Captive Insurance Company (“insurer”) and assist the insurer in developing investment strategies suitable to the size and complexity of their operations that will demonstrate that it is managing its investment portfolio in an appropriate manner.
- 1.3 A key element of any insurance business is its investment portfolio. An investment portfolio carries with it a range of investment-related risks that might affect the financial strength of an insurer and, consequently, require sound management. In order that insurers can demonstrate that they manage their investment business in a sound and prudent manner they should ensure that they have a written investment strategy and procedures in place that enable them to identify, measure, report and control the main investment-related risks that they face.
- 1.4 Investment management processes and procedures must take into consideration the nature of the insurer’s liabilities, the size and the complexity of the insurer’s asset portfolio, the ability of the insurer to absorb potential losses and the overall strategic business objectives of the company. At a minimum insurers should conduct a detailed analysis of the management of their assets and liabilities and ensure that safe custodial arrangements exist, that assets appropriately match liabilities and that their asset portfolios are adequately diversified and liquid to enable them to meet their claims and other obligations as they fall due.

2 Application

- 2.1 This Practice Direction applies to all Captive Insurers licensed under the Insurance Act, 1994. It sets out the minimum policies and procedures that each insurer needs to have in place and apply to prudently manage its investments.
- 2.2 Regulation 11 of the Insurance Regulations, 1995 requires every licensed insurer to maintain at its principal office in the Territory such books and records of its financial affairs as will enable the Commission at any time to ascertain with

reasonable accuracy its financial position. To comply with the requirements of this regulation all Insurance Managers will be expected to have available to them information relating to the insurer's investment plans, any investment managers and advisers that are employed or used and details of all investment transactions carried out by the insurer.

- 2.3 As part of its supervisory responsibility, the Commission will look for indications that the insurer has in place procedures for the prudent management of its investments. When assessing these procedures the Commission will take into consideration the size and complexity of the insurer's operations. The Commission realises that the majority of Captives licensed under the Insurance Act, 1994 mainly insure or reinsure the risks of their owners. While they pose less risk to the public than other insurers or reinsurers that are involved in related party transactions the Commission will expect the Board of Directors and Management to exercise diligence in their management of the insurer's investments.

3 Board of Directors

- 3.1 The Board of Directors is responsible for formulating the investment policy of the insurer and ensuring that it is implemented. They should, along with key management staff, possess sufficient expertise to understand the important issues related to investment management.
- 3.2 In formulating the investment policy the Board of Directors should analyse:
- o the asset/liability relationship. That is verify that the insurer will have sufficient liquid assets to meet liabilities as they fall due;
 - o the insurer's overall risk tolerance and its long-term risk and return requirements; and
 - o the insurer's solvency position.
- 3.3 The Board of Directors must also ensure that adequate reporting and internal control systems for the insurer are in place to provide evidence that assets are being managed in accordance with the investment policy and legal and regulatory requirements.
- 3.4 The Board of Directors should review the adequacy of the overall investment policy at least annually to ensure that it meets the needs of the company's activities, risk tolerance, expected long-term return and solvency position.

4 Management and/or Insurance Manager

- 4.1 The formulation of the operational policies and procedures for implementing and reviewing the investment policy is the responsibility of management. This activity might be undertaken by its BVI resident Insurance Manager. In any event the Insurance Manager of the insurer should be well versed in and understand the insurer's investment strategy and how its investments are managed. This should include ensuring that the original business plan of the insurer when it applies for an insurance licence includes appropriate reference to the company's proposed investment policy and that the policy is in compliance with regulatory requirements.
- 4.2 Management/Insurance Manager should ensure that all individuals conducting, monitoring and controlling investment activities are suitably qualified and have appropriate levels of knowledge and experience.
- 4.3 At least annually, Management/Insurance Manager should review the adequacy of its written operational procedures and allocated resources in the light of the insurer's activities and market conditions.

5 Investment Policy

- 5.1 All insurers should have a written investment policy in place which has been approved by the Board of Directors. The complexity of such a policy will depend upon the nature of the business undertaken. The policy should be flexible and adjustable to changes in internal and external market conditions and other risk factors. It should contain contingency plans to mitigate the effects of deteriorating conditions.
- 5.2 This Practice Direction highlights the areas that an investment policy should address, at a minimum:
 - o Risk Profile - The risk profile of the insurer should set out the risks faced by the insurer as well as the extent to which the insurer is willing to assume various types of risk. Typically risks would fall under the headings insurance underwriting, investment, liquidity and credit risks. Scenario analysis can be used to test the investment portfolio's ability to withstand varying risk levels. The risk profile of the insurer should also indicate how these risks will be mitigated. For example risks are reduced through the diversification of the investment portfolio and investing in different asset categories, markets, sectors and geographical areas.
 - o Allocation of Assets (asset mix) - The insurer should identify how it intends to allocate its resources over broad investment categories such as equities, bonds,

cash and property. The insurer should also indicate what individual assets will make up each asset category and the percentages.

- o Selection Criteria - The insurer should indicate what criteria are to be used in the selection of broad investment categories and the individual securities or assets that form the investment portfolio. The investment policy should indicate the minimum acceptable credit or investment rating for securities investments or issuers of securities and provide for the use of financial derivatives. The insurer should also maintain a list of investment activities or investment practitioners that they are authorised or not permitted to engage in or with. Regulation 8 of the Insurance Regulations, 1995 indicates assets that are allowable for the purposes of the insurer meeting its minimum margin of solvency.
- o Concentration Limits - The insurer should have clearly defined and documented securities portfolio concentration limits. This will ensure that the nature and level of an insurer's exposure to various risks such as credit risk, interest rate risk, currency risk and price risk are monitored when making investment and credit decisions. All limits need to be established in the context of the insurer's aggregate investment and credit exposure and not in isolation.
- o Portfolio Performance Criteria - Risk and return are generally directly related. Consequently, the insurer should have an idea of the level of return acceptable based on the risk level of the investment portfolio. The insurer should also have an indication of the time frame over which the acceptable rate of return is expected to be received, along with the expected volatility of that rate.
- o Selection of Investment Personnel - The investment policy should identify the criteria used for the selection of internal and external investment managers. This should include security dealers and other related counterparties. These key personnel must have the appropriate level of skills, experience and integrity to perform their duties adequately.
- o Asset/Liability Management strategy - The investment policy of an insurer should anticipate the insurer's short-term and long-term cash needs and address how these needs will be provided. The insurer's investment portfolio should be constituted in such a way as to reflect the cash needs of the insurer and any anticipated changes in them. Investment activities should take into consideration the asset/liability position of the insurer since it is important to ensure that liabilities can be settled as they fall due.
- o Liquidity of Investments - The investment policy should make provisions so that assets are not liquidated unexpectedly and potentially at unfavourable prices and

that the portfolio does not contain excess amounts of cash or low yielding liquid assets.

- o Related Party Transactions - The investment policy should set out the criteria for assessing the extent and significance of related or connected party transactions.
- o Accountability Requirements - The investment policy should contain a framework of accountability for all asset transactions. Each insurer needs to implement accounting policies and information systems to monitor the transactions that take place in its investment portfolio.
- o Valuation Policies - The investment policy should indicate the methodologies used in the valuation of assets and calculation of liabilities. Regulations 9 and 10 of the Insurance Regulations, 1995 outline valuation requirements for assets and liabilities respectively.

5.3 Solvency Requirements - In developing the investment policy the Board of Directors must take into consideration the solvency margin (the amount by which the total value of an insurer's allowable assets must exceed the total amount of liabilities) requirements of the insurer. Insurers are required to meet a minimum level of solvency whether they are conducting general or long-term business. Regulation 7 of the Insurance Regulations, 1995 identifies the solvency requirements for insurers.

6 Internal Control and Internal Audit Procedures

- 6.1 The investment activities of the insurer must be governed by sound internal control and internal audit procedures. An internal control system in this context should ensure that investment activities are conducted in accordance with the approved policies and procedures of the insurer and the applicable legislation and regulation. Internal audit procedures should be objective, transparent and clearly defined and the internal audit process should be conducted independently of those managing the assets.
- 6.2 Internal control systems should at a minimum include:
- o procedures to ensure that investment transactions are properly documented and authorised and that the formal documentation is completed promptly and accurately;
 - o systems to measure, record and monitor security positions and market conditions;
 - o procedures to ensure that guidelines outlined in the investment policy are adhered to such as:

- ensuring that restrictions on certain assets are observed
 - ensuring that the insurer's diversification policy is observed
 - ensuring that any asset transaction limits are not exceeded
 - o procedures to ensure that any breaches or inaccuracies in investment activity are reported on a timely basis and remedial action is taken;
 - o procedures to ensure that there are timely reports on investment activity; and
 - o procedures to ensure reconciliation of security positions and that these positions are promptly settled and reported.
- 6.3 Internal audits are important because they provide an objective assessment of investment performance and the integrity of the management of the investment activity. The internal audit process is also vital in the detection of problems or potential problems. The internal audit should test to determine whether certain policies are in place to ensure that:
- o the insurer's asset portfolio and written investment management policies and procedures are in compliance with the insurer's regulatory obligations, including BVI laws and regulations;
 - o investment transactions are duly authorised and accurately and completely recorded;
 - o recorded securities exist and are valued based on the relevant laws and regulations; and
 - o internal control weaknesses and operating and accounting system deficiencies are identified and reported.

The Official Seal of the Commission is affixed hereto this 29th day of August, 2006.



Robin Gaul
Chairman of the Board of Commissioners
Financial Services Commission



British Virgin Islands Financial Services Commission