

**Cyprus: Financial Sector Assessment Program Update—
Technical Note—Insurance Regulation and Supervision**

This Technical Note on Insurance Regulation and Supervision for Cyprus was prepared by a staff team of the International Monetary Fund as background documentation to the Financial Sector Assessment Program with the member country. It is based on the information available at the time it was completed in May, 2009. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of Cyprus or the Executive Board of the IMF.

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FINANCIAL SECTOR ASSESSMENT PROGRAM UPDATE

REPUBLIC OF CYPRUS

TECHNICAL NOTE

INSURANCE REGULATION AND SUPERVISION

MAY 2009

INTERNATIONAL MONETARY FUND
MONETARY AND CAPITAL MARKETS DEPARTMENT

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GLOSSARY

CC	Commercial Code of Cyprus
CEIOPS	Committee of European Insurance and Occupational Pensions
CySEC	Cyprus Securities and Exchange Commission
EEA	European Economic Area
EU	European Union
FSAP	Financial Sector Assessment Program
FOS	Freedom of Service
GWP	Gross Written Premium
IAIS	International Association of Insurance Supervisors
IAC	Insurance Advisory Committee
ICCS	Insurance Company Control Service
ILPs	Investment-Linked Policies
ILS	Insurance Law on Supervision
MoF	Ministry of Finance
OFC	Offshore Financial Center
SI	Superintendent of Insurance
STRs	Suspicious Transactions Reports
TN	Technical Note

EXECUTIVE SUMMARY

The Cypriot Insurance Company Control Service (ICCS) has introduced significant supervisory and regulatory reforms in the insurance area since the last assessment in 2005. The regulatory approach is in principle reflective of and appropriate for the low complexity and sophistication of the insurance market in Cyprus. Since the last assessment in 2005, the ICCS has been empowered to acquire and customize an IT-based information system. This will in the near future process prudential data, create regular and ad-hoc reports, and support the off-site analysis.

However, and despite a significant increase in supervisory resources, the ICCS is still not empowered to recruit the resources it needs to perform its core duties. This is particularly pressing in the area of legal advice, where there is a continuous need to review market and regulatory developments, especially with the introduction of Solvency II. The Superintendent of Insurance (SI) is not allowed to recruit such resources or to contract expertise from the market. Instead, as a department of the Ministry of Finance (MoF), the ICCS has to apply for support from within the Ministry. Currently, ICCS has to draw from external sources and the legal services from the Attorney General's Office. Not having legal expertise in the supervisory authority is a clear violation of international's accepted standards on supervision and undermines the independence and operational capability of the ICCS. It hinders the building of expertise and capability within the ICCS. Moreover, new regulation is delayed and developments such as Solvency II cannot be actively supported.

It is not clear that companies conducting nondomestic business in markets outside the European Union (EU) meet all regulatory requirements of those markets. Those companies meet all the existing requirements under the Insurance Law of Supervision (ILS) and do report their results to the ICCS. However, there is no proof that their business activity is in compliance with regulation in those non-domestic markets. Therefore the SI should require written confirmation from those companies that they are in contact with local regulatory authorities and that all existing standards and regulation are being met. Where those confirmations are not submitted by licensed entities, the respective market authorities should be informed accordingly.

The ICCS does not conduct on-site inspection on a regular and planned basis. There is inspection activity only on specific issues. In preparation for an on-site visit plan, the design of on-site inspections should be completed and a handbook for on-site work should be developed.

Current regulation allows companies to invest up to 50 percent of their technical reserves in a counterparty that is an appropriate credit institution, of which no more than 10 percent shall relate to assets other than deposits. This regulation does present an

unnecessary market risk. In fact, there are four insurance companies that have more than 40 percent of their assets with only one counterparty in one non-tradable financial instrument. The regulation on concentration risk should be amended and companies should be asked to provide a viable plan to comply with it over an appropriate timeframe.

The solvency position of each company is assessed annually based on audited returns.

There is a severe delay caused by auditing processes and company procedures. In average, the returns as of December 31 arrive at the ICCS in late June or early July. It would be desirable to receive the accounts much earlier. Therefore, the ICCS should request companies to send in preliminary reports. ICCS could update its data later when the audited accounts arrive.

I. BACKGROUND

1. **This examination of Cyprus' insurance regulation and supervision regime was conducted to update the Offshore Financial Center (OFC) assessment undertaken in 2005.** The evaluation is based on relevant international benchmarks established by the International Association of Insurance Supervisors (IAIS). The assessment, which focused on critical areas and significant developments since 2005, was conducted from September 22 to October 6, 2008.¹
2. **The update is based on (i) progress reports prepared by the ICCS; (ii) a review of applicable laws, regulatory and supervisory guidance, and procedures; (iii) analysis of regulatory and market data; (iv) interviews with staff of the authority and the Superintendent, industry participants, industry, and professional associations; and (v) documentation provided by various interviewees.** Consequently, this technical note (TN) focuses on the regulatory and supervisory framework. Appendix I list the companies and industry and professional associations interviewed.

II. MARKET STRUCTURE AND PERFORMANCE

3. **There are currently 40 companies being supervised under the powers of the SI.** The total gross written premiums (GWP) for those companies amount to EUR 1,196 million. The total underwriting results for the non-life businesses are EUR 114 million and the net profit from the Life businesses is EUR 52 million. All figures are based on results as at December 2007.
4. **The direct insurance industry in Cyprus is mature but relatively unsophisticated.** Partly due to the small domestic market, Cyprus exports insurance services within the EU and to selected markets such as the Middle East and Russia. The non-domestic GWP amounts to EUR 113.00 million for life and EUR 451 million for the non-life business—mainly reinsurance business.
5. **The number of insurers (11 life insurers, 21 non-life insurers and 8 reinsurers) operating in Cyprus has been steady.** Only three insurers exited the market due to merger or closure. In addition, 46 branches of insurers headquartered in other EU states had notified their intention to carry on business on a freedom of service (FOS) basis. These insurers could offer a wide range of products and services to the Cypriot market. The ICCS receives only aggregated information on GWP from the home supervisors of those firms. The information

¹ The assessment was conducted by Henning Göbel, Deputy Director Financial Markets, BaFin Germany.

indicates that the almost all of those FOS firms are not providing any services and products to the Cypriot market. More than 1900 employees work in the direct insurance industry.

6. Total premiums written by the direct insurance industry in Cyprus amounted to EUR 632 million in 2007, equivalent to 4.1 percent of GDP, roughly divided equally between life (EUR 310 million) and non-life insurance premiums (EUR 322 million).

About 65 percent of new life premiums are from investment-linked policies (ILPs). The domestic non-life market is dominated by motor insurance which accounted for 58 percent of net premiums. Products in the non-life market are very traditional, for example, credit insurance accounts for only 0.02 percent of both domestic and non-domestic premiums.

7. Both the life and non-life insurance industries are highly concentrated. In the domestic life sector, the top 5 life insurers wrote 78 percent of the total business premiums in 2007. The top two life insurers, which are bank-owned, had a combined market share of 42 percent at end 2007. The top 10 nonlife insurers assumed more than 70 percent of the domestic risks. The top three non-life insurers assumed more than 35 percent of domestic risks. Subsidiaries of foreign groups are not key players in the Cypriot market, with a market share of less than 5 percent.

8. Total assets held by the insurance industry reached EUR 3,984 million as at end-2007, of which life insurers held EUR 3,019 million (76 percent), while non-life insurers had EUR 313 million (8 percent) and reinsurers hold EUR 651. million (16 percent).

About 48 percent of non-life assets were invested in fixed interest deposits, 19 percent in property and 15 percent in equities. Government bonds or other fixed interest securities account for only 6 percent.

9. All Cypriot business is reinsured with non-domiciled reinsurers. However, Cyprus hosts two reinsurers which write non-domestic business and account for 46 percent of the total non-life business. The retention rate for non-life is 79.4 percent and has been stable for the last three years. Health insurance is regulated as non-life business when written as add-ons to accident and sickness or as Life business when written with life policies.

10. The SI is responsible for the regulation and supervision of the insurance market.

The SI is also Director of the ICCS, the Supervisory Authority for insurance, which is a Directorate of the MoF. The SI and her deputies are civil servants appointed in the posts of SI and Assistant SI by the Council of Ministers. Prior to this, the SI had to report to the Auditor General, another department of the MoF. The SI is responsible for the supervision of all insurance activities, comprising insurance undertakings and distribution of insurance products.

11. A number of professional bodies and self regulatory industry associations complement the regulatory regime for the insurance industry. These include the Cyprus

Association of Actuaries, the Cypriot Insurance Agency Association and the Institute of Certified Public Accountants of Cyprus with more than 2500 fellow members.

III. IMPLEMENTATION OF IAIS INSURANCE CORE PRINCIPLES

A. Conditions for Effective Insurance Supervision

ICP 1, Conditions for effective insurance supervision

12. **The ICCS operates within the legislative framework determined by the ILS and the relevant EU Directives.** It provides policy inputs to the MoF and other government departments in the negotiation and implementation of relevant EU Directives. This includes the consolidation and harmonization of financial services legislation. The ICCS participates in the development and negotiation of the Solvency II directive.

13. **The actuarial profession plays a key role in supplementing the regulatory regime and has a general whistle blowing responsibility.** The Cyprus Actuarial Association is still a small but growing association and provides guidance to actuaries employed by or contracted to insurance companies. Actuaries are expected to be independent of company management and act in accordance with professional guidance. As at October 2008, there were 56 Actuaries registered by the association.

14. **Since the last assessment, regulation has been updated and international cooperation with other supervisors has been fostered.** However, at the time of the update, there was still a via among industry representatives and others that the court system could improve on its effectiveness and efficiency.

B. The Supervisory System

ICP 2, Supervisory objectives

15. **The SI has issued further guidelines to clarify how she wants certain provisions of the ILS to be applied.** This assisted in clarifying overall supervisory objectives. The SI also chairs an Insurance Advisory Committee (IAC) which is composed of the SI, her two deputies and four individuals appointed by the MoF after consultation with the Insurance Association of Cyprus. Through that forum, the SI can also ensure that supervisory objectives are understood by key decision makers in the regulatory environment.

16. **The ICCS embeds its mission and values in its strategic plans.** On a strategic level, the ICCS aims to follow all developments on Solvency II closely to prepare for a smooth transition. The main objective on operational issues is to increase operational capability through utilization of IT-supported systems.

17. **At the last assessment, it was recommended to communicate more clearly with the markets on objectives and processes within the ICCS.** There seems to be little progress in that respect. The latest annual “Report on Insurance in Cyprus 2006” could have been used to communicate more effectively with the market and interested stakeholders. Various circulars and guidance have since been issued by the SI directly to supervised entities assisting them on the interpretation of the Law.

ICP 3, Supervisory authority

18. **The ICCS has much improved as an organization and has increased staffing levels substantially in quality and quantity.** The recruitment of two actuaries will allow the ICCS to discharge most of its duties more effectively. The recruitment of two additional accountants is also a progress, although significant training needs to be given to allow those to analyze returns and accounts.

19. **The ICCS is still not empowered to recruit the resources it needs to perform its core duties.** The application of the supervisory ladder depends on legal advice given to the SI that all decisions are in compliance with existing regulation. Despite the obvious need to access legal advice in this process, the SI is not allowed to recruit or contract dedicated and specialized legal resources from the market. Instead, as a department of the MoF, the SI has to apply for support from the Attorney’s General Office. This will hinder the SI in building expertise and capability within the ICCS. Moreover, new regulation is delayed and developments such as Solvency II cannot be actively supported. Such a restriction to keep legal expertise out of the supervisory authority is a clear violation of internationally accepted standards on supervision and undermines the independence and operational capability.

20. **Despite the improvement on staffing levels, other recommendations under this principle have not been implemented.** Budgeting autonomy is still not granted to the SI. Final authority to issue orders and guidance can be influenced by the MoF.

ICP 4, Supervisory process

21. **The Supervisory process has improved overall. More guidance on internal processes is available and will be supported through more support from IT based information.** This will allow an increase in efficiency and effectiveness within the ICCS. However, some supervisory processes depend on interaction with external sources or third parties. To that extent, little progress has been made. The appeal process still undermines the credibility of the ICCS since all major decisions can be subject to an appeal with the MoF. No change has been made despite the Financial Sector Assessment Program (FSAP) recommendations.

22. **All laws, regulations, notices, guidelines, etc, prior to enactment are subject to an appropriate consultation process and after enactment are available on the website of the ICCS.** Related parties and professional bodies such as the Insurance Association and the accounting profession are consulted to ensure broad agreement and high quality.

23. **All licensed entities and intermediaries have free access to the local insurance market without discrimination.** The laws clearly define their rights and obligations and the insurance authority enforces these laws accordingly.

24. **Administrative decisions, including sanctions, can be appealed.** A concern is that such an appeal can thwart timely interventions by the regulator and potentially undermine policyholders' interests. More power should be delegated to the regulator or the appeal process should be changed to prevent the withholding of sanctions against an undertaking where necessary to protect policyholders.

ICP 5, Supervisory cooperation and information sharing

25. **The ICCS observes the home-host protocol between EU regulators, pursuant to the freedom to provide services principles.** On notification from a home regulator to a host regulator that an insurer based in the home state intends to write insurance in the host state, the host regulator sends a copy of the general good requirements for that state to the home regulator to forward to the insurer. The general good requirements identify areas of local legislation that apply in that state. On receipt of such requirements, the SI issues them to insurers intending to write business in those states.

26. **There are licensed insurance companies which are conducting non-domestic business outside the EU.** Those companies meet all the existing requirements under the ILS and do report their results to the ICCS. However, there is no proof that their business activity is in compliance with regulation in those non-domestic markets. Therefore the SI should require written confirmation from those companies that they are in contact with local regulatory authorities and that all existing standards and regulations are met. Where those confirmations are not submitted by licensed entities, the respective market authorities should be informed accordingly. In general, it would be desirable to establish cooperation and coordination arrangements with these supervisory authorities.

C. The Supervised Entities

ICP 6, Licensing

27. **The licensing regime in Cyprus is in line with the structure of the EU single market.** Financial services firms are categorized into: (i) those authorized by the SI; (ii) those authorized in another EU or European Economic Area (EEA) state that have at least

one branch in Cyprus (establishment firms); and (iii) those authorized in another EU or EEA state that provide services into Cyprus without setting up a physical presence in Cyprus (passporting firms).

28. **The licensing requirements are in line with IAIS standards and the legal limitations in dealing with certain persons who are not fit and proper should be addressed under the proposed new fitness and propriety regime.** The SI has no explicit legal power to require significant owners, who no longer meet fit and proper requirements, to dispose of their interests in insurance entities. However, the SI has the power in accordance with section 149(3) of the Insurance Law to demand when actions or omissions of owners result in the detriment of sound and prudent management to indicate corrective action to be taken. Further, in case of non compliance under section 150(4) the SI may take measures for the termination of the adverse influences exercised by owners, and may remove them from the Board of Directors and from any management post, postpone the exercise of voting rights until the taking of measures or forbid any new transaction with the Cyprus insurance company or declare due and claimable all loans taken by the insurance company. The SI can also withdraw authorization as a last resort in extreme situations. The SI is also not empowered explicitly to disqualify key functionaries including actuaries of insurers that do not comply with fit and proper requirements. While actuaries require practicing certificates from their respective professional bodies to continue practice, such decisions reflect professional standards that may not be fully in line with regulatory standards. Under the proposed new fitness and probity regime, insurers will be required to notify the ICCS of any changes regarding fitness and probity of senior personnel.

ICP 7, Suitability of persons

29. **There were no recommendations on suitability of persons in the last assessment.** However, the SI could extend the requirements on suitability of persons also to key functionaries.

ICP 8, Change in control and portfolio transfer

30. **There have been no recommendations on change in control and no incidents were reported.**

ICP 9, Corporate governance

31. **The ILS has no specific provisions for corporate governance.** However, all supervised entities are established as limited companies and are subject to governance rules as laid out in the commercial code of Cyprus (CC). The biggest companies are part of listed groups and are subject to governance rules set by the Cyprus Securities and Exchange Commission (CySEC). The range of size of companies and the differences in complexity

does not make it easy to define minimum standards. But the ICCS could collect existing governance rules of supervised companies to identify the quality of governance, and look at practices in other jurisdictions. Based on this information, governance requirements could be issued, and tailored to specific companies if needed.

ICP 10, Internal control

32. **There are no specific requirements on internal control laid out in the ILS.** Arguably, the supervised undertakings vary in size and complexity so much that only a principled-based regulation would be applicable. Such principles would not necessarily lead to improvements. Specific attention should be paid to this matter during the planned on-site inspections in 2009.

33. **Branches of foreign companies might be subject to different requirements on internal control through their parent companies.** It is therefore recommended that information on those requirements be collected and that they be enforced.

D. Ongoing Supervision

ICP 11, Market analysis

34. **The ICCS has improved its capabilities on market analysis significantly.** Information received can now be processed, stored and used to generate ad-hoc reports. Also, contribution to cross-sectoral oversight can now be provided. Market trends can be realized earlier and benchmarking of individual companies against peer groups is now possible.

35. **The ICCS collects relevant information on investments and other assets on a quarterly basis.** The market analysis should be extended to not only the collection of information from supervised companies but also to the collection of macro-economic data to be the basis for further analysis.

ICP 12, Reporting to supervisors and off-site monitoring

36. **Insurance companies are required to submit the balance sheet, profit and loss statements and other financial data prescribed in the ordinance issued by the ILS including a subset containing information on investment activity.** For the purpose of off-site monitoring, the ICCS has recently generated standard reports which will bring to the officer's attention any deviation from expected results or previous trends. Reports should be standardized for both life and non-life business.

37. **ICCS should strengthen its framework for analyzing off-site information.** It should develop a process which collects information on four aspects. Financial information on a quarterly basis, including claims provisioning and key ratios. Operational information

on company's activities and possible constraints. Solvency information which allows the ICCS to evaluate and project current solvency position of the company and to arrive at advanced information on any possible breach of capital requirements of a company. The fourth aspect concerns the comparison of performance and trends with market average and benchmarking against peer groups. Each set of information should be reviewed to assess whether the previous assessment is still valid or whether severe changes have affected the entity. On-site inspections should be initiated when new information deviates from previous trends and analysis. Outcome of analysis of off-site monitoring should trigger priorities for on-site inspections.

ICP 13, On-site inspection

38. **The ICCS does not conduct on-site inspection on a regular and planned basis.** There is inspection activity only on specific issues. In preparation for an on-site plan, the design of on-site inspections should be completed and a handbook for on-site should be developed. A competent on-site inspection manual has been prepared by ICCS's consultants, the Government Actuaries Department in the U.K. but this has to be adjusted to suit the needs of ICCS.

39. **To allow a structured approach to on-site inspections, ICCS should develop a risk rating system to prioritize regulatory resources based on the risk profile of regulated entities.** This should be a structured approach to take account of the inherent risks, the related business processes, and the potential impact of failure. Risk weightings should be assigned to categories of inherent risks: group structure, supervisory complexity, corporate governance, capital, contagion and related parties risk, business risk, reputational risk, regulatory risk, operational risk, credit risk, market risk, insurance risk, etc. An entity's organization structure, which may have a risk impact, should also be assessed.

ICP 14, Preventive and corrective measures

40. **The ICCS has a sufficient range of corrective measures to respond in a timely manner.** Currently, the ICCS does administer a progressive escalation of sanctions or remedial measures that is appropriate to each case. A supervisory ladder would provide for appropriate responses to situations, where problems become worse or if management of the insurer ignores more informal requests from the supervisory authority to take corrective action. ICCS should develop such an escalation process and inform relevant staff and undertakings about the preventive measures to be taken in future.

ICP 15, Enforcement or sanctions

41. **The previous assessment recommended the strengthening of the powers of the SI and to revise the appeal process of sanctions.** There have been no changes made to the ILS

in this area. Moreover, there seems to be resistance from the industry to support changes to the appeal process. In part this is due to sub-efficient responses from commercial courts.

ICP 16, Winding-up and exit from the market

42. **There are minor issues on the winding-up provisions in the ILS which should be amended when a larger revision of the ILS is conducted.** These issues comprise the participation of policyholders in winding-up or liquidation and a larger independence of the SI in the process. The SI should also have plans prepared to react to winding-ups and have a contingency plan in place.

ICP 17, Group-wide supervision

43. **All recommendations from the last assessment have been implemented.** Furthermore, relevant work streams of the EU working groups on Solvency II are followed and considered by the ICCS and related insurance companies.

E. Prudential Requirements

ICP 18 Risk assessment and management

44. **The SI does not currently issue any guidelines or regulations on risk management.** However, information regarding measuring, assessing, reporting and controlling of risk, forms part of the business plan submitted by the insurer at the time of licensing. Should there be any changes in the risk assessment and management policies of the insurer thereafter, such information has to be disclosed to the ICCS.

45. **It is expected that with the preparation for Solvency II all companies will experience the effect of risk based capital requirements and will therefore pay stronger attention to risk management approaches.** It will be essential for the ICCS to build up capabilities to effectively supervise insurance companies in that respect. The European Insurance Committee intends to establish colleges to train supervisors in that respect. ICCS should participate and also contact the Cypriot banking supervisor to take all opportunities to increase knowledge on shared challenges.

ICP 19, Insurance activity

46. **The last assessment recommended the ICCS to ask the supervised companies to provide a risk profile stating the introduction of new products, availability of rating factors and changes in its attitude to insurance risks.** The ICCS confirmed that with the introduction of the recommended changes to off-site monitoring it will also collect the risk profile of companies and information on business plans and activities.

ICP 20, Liabilities

47. **The ICCS has improved significantly in this area.** It not only provided the additional staff with the capability to assess the adequacy of reserves but it also required information on chain ladders and claims triangles. The analysis of this information will enable the ICCS to identify shortfalls on reserving levels and insufficient premium levels.

48. **Further improvements could be achieved if the ICCS would require the information to be submitted quarterly.** It must be assumed that companies have to keep their accounts updated and therefore should not have a problem submitting the data quarterly. The ICCS could then analyze claims performance more quickly and also project the inter-annual position on solvency.

ICP 21, Investments

49. **The ICCS has implemented better and more timely analysis of insurers' investments.** Investments in complex or structured products are prohibited. There is little exposure to international financial markets outside the EU but a high exposure to the local property and equity markets. Some equity exposures are highly concentrated with few local counterparties. Those companies should be granted the ability to hedge their positions. Relevant meetings between ICCS and companies should be conducted soon.

50. **Current regulation allows companies to invest up to 50 percent of their technical reserves in a counterparty that is an appropriate credit institution, which no more than 10 percent shall relate to assets other than deposits.** This regulation does present an unnecessary market (interest rate) risk. In fact, there are four insurance companies which have more than 40 percent of their assets with only one counterparty in one non tradable financial instrument. The regulation on concentration risk should be amended and companies should be asked to provide a plan for compliance over an appropriate timeframe.

51. **At the time of the update, 17 companies had invested more than 30 percent of their total assets in bank deposits totaling EUR 477.71 million or 45 percent of all deposits by insurers.** The five companies with highest exposure to bank deposits have invested a total of EUR 31. 1 million or 64 percent of all assets deposited by insurance companies with banks. The overall amount of assets deposited with banks is EUR 1,053.95million.

ICP 22, Derivatives and similar commitments

52. **There were no recommendations in the last assessment.**

ICP 23, Capital adequacy

53. **The current solvency/capital regime, based on the EU Solvency I, is not risk sensitive.** Solvency/capital requirements are based on premium levels and/or reserve levels. In practice, Cypriot insurers possess on average a solvency margins of 180 percent of the requirement stipulated under Solvency I. Insurers are obliged to have minimum capitalization of not less than the minimum guarantee fund in accordance with the EU Directives, of which the paid-up share capital is one component. In line with the requirements of Solvency I, the minimum capital levels for insurers are: EUR 3.2 million for life not transacting accident and health business and non-life insurers; and EUR 2.2 million for non-life non-liability class insurers and EUR 5.4 million for life insurers transacting accident and health business.

54. **The solvency position of each company is assessed annually based on audited returns.** There is a severe delay caused by auditing processes and company procedures. On average, the returns as of December 31 arrive at the ICCS. It would be desirable to receive the accounts much earlier. Therefore, the ICCS should request companies to send in preliminary reports. ICCS could update its data later when the audited accounts arrive.

F. Markets and Consumers

ICP 24, Intermediaries

55. The recommendations have been implemented and careful consideration is given to a responsible allocation of resources. All European directives are implemented.

ICP 25, Consumer protection

56. **Consumer complaints will be deferred to an Ombudsman in the future.** The system for the establishment of a financial ombudsman has been submitted in 2007 by the MoF to the House of Representatives where it is still pending.

ICP 26, Information, disclosure and transparency

57. **The SI publishes trends and statistics about the insurance market every second year and is now moving towards an annual report.** The current level of detail of this report reflects the sophistication of the market and is sufficiently detailed on quantitative information. The qualitative information should be increased and should elaborate on trends and changes as well as on developments within the EU in relation to insurance. Also, quantitative information should be provided on a company level as this is not regarded as proprietary information.

ICP 27, Fraud

58. **The recommendations on ICP 10 are closely linked.** The main recommendations have not been implemented and little progress has been made to increase awareness within the companies to reduce the exposure to insurance fraud. It is recommended that the SI liaise with the International Insurance Fraud Agency to receive further input and to benefit from international experience on this issue.

IV. RECOMMENDED ACTION PLAN

Table 1. Recommended Action Plan to Improve Observance of Insurance Core Principles

<p>The Supervisory System 2–5</p>	<ol style="list-style-type: none"> 1. The SI should use the next edition of the Annual Report to communicate more effectively on the supervisory objectives and upcoming activities. 2. The SI should require written confirmation from companies conducting business in markets to outside the EU that they are in contact with local regulatory authorities and that all existing standards and regulation are met. Where those confirmations are not submitted by licensed entities, the respective market authorities should be informed accordingly.
<p>The Supervised Entities 6–10</p>	<ol style="list-style-type: none"> 3. The ICCS should assess existing governance rules of supervised companies to identify the quality of governance. Based on that assessment, bespoke governance requirements for specific companies could be issued. 4. The supervised undertakings vary in size and complexity so much that only a very principle based regulation would be applicable. Such principles would not lead necessarily lead to improvements. Specific attention should be paid to this matter during the planned on-site inspections in 2009.
<p>Ongoing Supervision 11–17</p>	<ol style="list-style-type: none"> 5. Market analysis should be extended to not only collect information from supervised companies but also collect macro-economic data to be the basis for further analysis. 6. The ICCS should strengthen its framework of analyzing off-site information. The analysis should cover financial, operational, solvency and market information. Each set of information should be reviewed to assess whether the previous assessment is still valid or whether severe changes have affected the entity. On-site inspections should be initiated when new information deviates from previous trends and analysis. 7. There are minor issues on the winding-up provisions in the ILS which should be amended when a larger revision of the ILS will be conducted. These issues comprise the participation of policyholders in winding-up or liquidation and a larger independence of the SI in the process. The SI should also have plans prepared to react to windings-ups and to have contingencies.
<p>Prudential Requirements 18–23</p>	<ol style="list-style-type: none"> 8. ICCS should participate in Committee of European Insurance and Occupations Pensions (CEIOPS) courses and also the Cypriot banking supervisor to take all opportunities to increase knowledge on risk management. 9. This regulation on concentration risk presents an unnecessary market

	<p>risk. In fact, there are four insurance companies which have more than 40 percent of their assets with only one counterparty in one non tradable financial instrument. The regulation should be amended and companies should be asked to provide a viable exit-strategy.</p> <p>10. ICCS should request companies to send in preliminary reports in order to receive relevant information on solvency positions earlier. ICCS could update its data later when the audited accounts arrive.</p>
<p>Markets and Consumers 24-27</p>	<p>11. The qualitative information should be increased and elaborate on trends and changes as well as on developments within the EU in relation to insurance. Also, quantitative information should be provided on a company level as this is not regarded as proprietary information.</p> <p>12. It is recommended that the SI liaise with the International Insurance Fraud Agency to receive further input and to benefit from international experience on this issue.</p>

V. AUTHORITIES' RESPONSE TO THE ASSESSMENT

The authorities were in broad agreement with the assessment.

Appendix I: List of Companies and Industry/Professional Associations Interviewed

Life Insurance Companies

EuroLife
Nicosia

Artemis Pantelidou,
General manager

Universal Life
Nicosia

Andreas Georghiou,
Chief Executive
Andreas Shakallis,
Actuary, Operations Manager

Alico AIG Life,
Nicosia

Antonios I Karpasitis,
General Manager

Non-life insurance companies

Commercial General Insurance
Nicosia

Constantinos Dekatris
Group managing Director

Industry and Professional Association

Cypriot Insurance Association
Nicosia

Philios Zachariades
Chairman,
Dimitris Dimitriou
Secretary

KPMG,
Nicosia

Michael Antoniadis
Partner

PWC
Nicosia

Androulla Pittas, Partner
Christos Tsolakis, Partner

Appendix II: Authorities Response to the Assessment of 2005

ICP	FSAP Recommendation in 2005	Response
<p>ICP 1</p> <p>Effective Insurance Supervision</p>	<p>Regulation has to be developed to set a framework in which insurance undertakings can operate and in order to create clear expectations from a supervisory standpoint towards the companies.</p>	<p>Since 2005 legal services from the European Public Law Center in Greece have been acquired for further harmonization of the LIS and its Regulations with new EU Directives. The House of Representatives has already approved the new amendments into Law. The LIS and its Regulations constitute the legal framework of the insurance sector in Cyprus.</p>
<p>ICP 2</p> <p>Supervisory Objectives</p>	<p>Clear objectives and measures should be defined for the SI and the ICCS. The SI and the ICCS should report on their achievements on a regular basis. Moreover, the SI should communicate through regulation how he wants the LIS to be applied.</p>	<p>Since 2005 the “Report on Insurance in Cyprus” has been published annually. Also the SI has issued many instructions through Circulars to Insurance entities regarding the application of the LIS and its Regulations. In this way Insurance entities have a clearer view of their obligations/responsibilities/tasks under the existing legal framework.</p>
<p>ICP 3</p> <p>Supervisory Authority</p>	<p>The SI has to be granted a budget in order to perform the duties laid out in the LIS. Also, the SI should be charged with producing a plan laying out the priorities for a year. Those plans would set clear expectations for the Council of Ministers and for the staff of the ICCS. Most importantly, there is an urgent need to assess the composition of skills required to properly exercise the powers of the LIS. Whether all those skills identified will have to be allocated within the ICCS remains to be seen. At the time this assessment was carried out, the SI was not provided with resources adequate to perform insurance supervision which is able to respond to critical situations.</p>	<p>Since 2005 and specifically between September 2007 and March 2008, more qualified staff have been appointed for the ICCS by the Civil Service Commission, as follows:</p> <ul style="list-style-type: none"> ▪ 2 Senior Insurance Officers, who are qualified Actuaries and have been appointed as Deputy Superintendents of Insurance ▪ 2 Insurance Officers A' who are qualified Chartered Accountants ▪ 1 Administrative Officer with accounting and financial academic background ▪ 3 Insurance Officers with economics and financial academic background ▪ 1 Assistant Insurance Officer with academic background <p>One more Insurance Officer is expected to be employed by the end of 2008 and one more Assistant Insurance Officer in 2009. All the above-mentioned new staff constitutes a significant addition to the existing professional staff of the ICCS which has in this way almost doubled since 2005. (The clerical staff remained largely the same in numbers since 2005). Also, since June 2008 the ICCS has introduced a complete computerization system.</p>
<p>ICP 4</p> <p>Supervisory Process</p>	<p>Given the very limited resources of the ICCS, a more efficient way of conducting ongoing supervision would free up capacity for more structural supervisory involvement. Internal procedures of the supervisor should be standardized for more efficient operation. Also, publications should be made available to the public.</p>	<p>The recruitment of additional personnel as described in ICP 3 has created a better organized and more effective staff structure within the ICCS, resulting in a more efficient allocation of duties according to skill specialization and experience. For the purposes of the computerization of the ICCS, a systems specification manual has been prepared listing all internal procedures.</p>

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<p>ICP 5 Supervisory Cooperation and information Sharing</p>	<p>There has not as yet been any information sharing since Cyprus joined the EU in May 2004. In 2005, the SI should contact the home supervisors to identify how many of the companies under the FOS have actually started business activities.</p>	<p>Since 2005 the ICCS is exchanging information on a regular basis with other EU supervisory authorities in this respect.</p>
<p>ICP 9 Corporate Governance</p>	<p>Since the number of small and family-owned businesses is substantial, the required control and balance mechanisms are not met for the sector as a whole, even though the corporate governance rules apply to listed companies. Nor is the application of corporate governance supervised or checked.</p> <p>There should be a joint effort to develop governing rules for undertakings in the financial sector. These rules should be developed by all three supervisory authorities.</p>	<p>Technical assistance is necessary for the implementation of this recommended action. The SI has already requested assistance from the Institute of Certified Public Accountants.</p>
<p>ICP 10 Internal control</p>	<p>Define standards on internal control as an essential part of sound insurance principles and enforce those standards through reporting and auditing requirements. Internal control procedures should also cover initial procedures for investment decisions and operational risk as it relates to contingency planning.</p>	<p>The ICCS has collected data with respect to internal control standards. The issue will be discussed soon with the Institute of Certified Public Accountants within the framework of the assistance already requested by the SI (see ICP 9)</p>
<p>ICP 11 Market analysis</p>	<p>The SI should identify the information about the insurance sector that is required or is of interest to other public services. The SI should also define all information necessary to prepare a market analysis for the insurance sector and determine the process through which this information will be received and updated.</p>	<p>Resulting from the increase of staff referred to in ICP 3, and the computerization of the ICCS, is the increased capacity of ICCS for more in-depth market analysis. The outcome of these developments has become more evident recently when the ICCS was in a position to successfully guide the Cyprus insurance industry in its participation in the Quantitative Impact Study 4 (QIS 4) for the Solvency II Directive which has been initiated by the European Commission. More importantly as far as ICP 11 is concerned, the ICCS has managed to prepare on time the Cyprus Country Report for QIS 4, following extensive stress testing of the insurance companies involved and relevant market analysis.</p>
<p>ICP 12 Reporting to supervisors and off-site monitoring</p>	<p>Company data should be stored electronically once received. Also, companies should be required to submit the relevant forms in signed hard copies and in electronic files in prescribed formats. That would allow the ICCS to have updated information on request without long delays and manual efforts. Also, there should be a procedure to imply some degree of plausibility testing</p>	<p>Since June 2008 the ICCS has introduced a complete computerization system. The system has a special procedure for testing the plausibility of figures in the Annual Accounting Returns.</p>

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	of received data.	
ICP 13 On-site inspection	Gain agreement from the MoF to obtain the right to contract third parties to support the carrying out of on-site inspections. Also, develop a plan to perform regular on-site inspections regardless of clear evidence that an inspection is deemed to be necessary.	With the recruitment of new qualified staff as described in ICP 3, the aim is to start regular on-site inspections of insurance companies. The preparation of a manual for on-site inspections is under consideration. Meanwhile, targeted on-site inspections will continue where necessary, especially following the review of the Annual Accounting Returns.
ICP 14 Preventive and corrective measures	The ICCS should develop a set of regulatory rules which would enable it to prevent a breach in compliance instead of deciding on corrective measures subsequent to a breach. Although, the emphasis should clearly be on corrective measures, the ICCS should consider whether the development of preventive measures could also contribute to a more efficient allocation of resources within the ICCS.	This proposed measure is now under consideration. However, the ICCS has never taken any preventive or corrective measures without warning insurance companies in writing and without informing them in advance of the legal consequences following non-compliance with the insurance legislation.
ICP 15 Enforcement or sanctions	The MoF should take steps to improve the independence and credibility of the SI and should therefore review the number of cases in which an appeal is possible. The MoF should review whether the variety of cases in which an appeal is possible should be reduced considerably.	The review of the appeal process is not an issue favored by the insurance industry which wants the appeal process to continue to exist as an intermediate step prior to resorting to courts, because the judicial system in Cyprus is very slow and court decisions are much delayed.
ICP 16 Winding-up and exit from the market	As s157 requires the SI to appoint a liquidator, the ICCS should have a short list of potential candidates in order to shorten the appointment process. That list should be part of the process of withdrawing a license.	The liquidation procedures so far have worked satisfactorily, as far as the appointment of liquidators are concerned.
ICP 17 Group-wide supervision	Incorporate relevant information exchange processes and terms of reference for the coordinator of financial conglomerate supervision into the 2002 MoU among the supervisors.	A relevant MoU for the exchange of information has been signed between the competent authorities of the financial sector in Cyprus. The Solvency II Directive under preparation will incorporate specific terms of reference for the coordinator of groups based on which the said MoU will be amended accordingly.
ICP 18 Risk assessment and management	Initial steps toward risk management should be considered when internal control procedures as laid out in ICP 10 are sufficiently regulated and recommendations are implemented through the establishment of sound insurance principles.	The response under ICP 10 is relevant. With regards to risk management In the context of Solvency II, a circular letter was sent to all insurance companies in April 2008 encouraging them to participate in QIS 4 in order to assess and evaluate their risks. As a result, seven companies have participated in QIS 4. Also a seminar to that effect was held in June 2008 and 27 insurance companies participated. For the purposes of analyzing and evaluating the changes to be brought by Solvency II, a technical committee has been formed by the ICCS which consists of members from the Institute of Actuaries, the Cyprus Insurance

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		Association, the Institute of Certified Accountants and the ICCS. The committee meets regularly under the auspices of the ICCS to discuss all Solvency II developments.
ICP 19 Insurance activity	The ICCS should ask the supervised companies to provide a risk profile stating the introduction of new products, availability of rating factors and changes in its attitude to insurance risks.	The upgrading of the quality of staff of the ICCS (see ICP 3) will enable the ICCS to implement fully this recommended action. (The said action is already implemented partially for the Life sector insurance companies as far as pricing and product range are concerned).
ICP 20 Liabilities	The determination of appropriate reserves requires that the ICCS has both the ability to contract external resources and recruit further adequately skilled staff. It is therefore referred to the relevant recommendations on ICP 1 and ICP 3.	Since 2005 additional professional staff which consists of two actuaries and two chartered accountants have been employed. Also, chain ladder methods are used widely since 2006 by the ICCS staff for the assessment of general business claims liabilities. Assessment of life liabilities is also carried out by the ICCS actuaries.
ICP 21 Investments	Company investment policy should be part of a risk profile which every insurance company should submit to the ICCS on a regular basis. Also, internal control procedures should cover initial procedures for investment decisions and on operational risk as it refers to contingency plans.	The ICCS is examining the investments risk profile for each category of liabilities (Property Linked, non-life, General Business etc), through analysis of the Investment Registers submitted to the ICCS by insurance companies every quarter. In addition, for Life Business only (since it is long-term business), the ICCS matches the said investment profile with a more detailed structure of the liabilities. It also assesses the relevant future expected return and then compares it with the valuation interest rate used by the appointed actuaries of insurance companies in their evaluation of the liabilities. Further improvement in this area (i.e., taking into consideration counterparty default risks), will result within the Solvency II framework.
ICP 22 Derivatives and similar commitments	None.	
ICP 23 Capital adequacy and solvency	<p>Cash collection of premiums should be an essential part of the internal control procedures. Premium receivables would not then accumulate to the existing levels and, therefore, not be a substantial issue.</p> <p>Solvency capital should be reported to the ICCS on a quarterly basis in order to avoid currently existing delays. There should be an awareness that it is unacceptable for companies to continue their operations if they are unable to meet the minimum requirements.</p> <p>There is also evidence that the Solvency I requirements, which will be enforced in</p>	<p>Since 2005 proactive supervisory action was taken for ensuring compliance with Solvency I requirements by insurance companies. As a result, all companies have successfully increased their capital levels to comply with Solvency I requirements.</p> <p>With respect to quarterly reporting, only the companies that are identified by the ICCS as having capital problems are requested to report their solvency levels on a quarterly basis.</p> <p>The rules governing the admissibility of premium debts as an asset for covering technical provisions, have been extended to premium debts covering the solvency margin through Orders issued by the Superintendent in March 2006.</p>

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	<p>March 2007 for existing businesses, will create difficulties for some of the smaller companies, mainly in General Lines. This problem is addressed in a technical assistance report.</p>	
<p>ICP 24 Intermediaries</p>	<p>Given the range of tasks undertaken by the supervisor, the planned allocation of resources, including those devoted to intermediary supervision, could be reviewed.</p>	<p>Since 2005 efforts are constantly made for maintaining the minimum possible allocation of resources for intermediary supervision, without jeopardizing the effectiveness of the ICCS in carrying out this type of supervision.</p>
<p>ICP 25 Consumer protection</p>	<p>The SI could publish the frequency of complaints received on a company level to initiate further incentives for companies to react in a more customer-friendly fashion.</p>	<p>The Bill for the establishment of a Financial Ombudsman has been submitted in 2007 by the MoF to the House of Representatives where it is still pending. A first reading and discussion between all parties concerned has already taken place on June 5, 2008 in the relevant Committee of the House of Representatives. At any rate the LIS includes provisions for minimum requirements for insurers and intermediaries when dealing with consumers which include provisions for timely, complete and relevant submission of information to consumers before and after a contract is signed.</p>
<p>ICP 26 Information, disclosure & transparency towards the market</p>	<p>Improve contents and frequency of market reports.</p>	<p>Since 2005 the Report is being published annually and its contents have been improved, though there is still room for further improvement which the ICCS is planning to adopt in future Reports.</p>
<p>ICP 27 Fraud</p>	<p>See ICP 10 recommendations for further details.</p>	<p>Developments in internal controls under ICP 10 will also include fraud issues.</p>
<p>ICP 28 Anti-money laundering</p>	<p>A common approach should be identified. Also, resources to deal with suspicious transactions reports (STRs) should be provided on an as-needs-basis. During the assessment of the life market, interviewed managers stated that most of the single premiums paid into unit-linked contracts had not been withdrawn from other forms of saving vehicles but had been provided either in cash or from other cash accounts. The sources of those premiums and their provision to the life insurance companies, however, have not led to submission of STRs to the SI.</p>	<p>On-site inspections will deal with money laundering issues as well. The SI has already issued Guidance Notes for the insurance companies compliance with the Prevention and Suppression of Money Laundering Activities Law.</p>