August 2007

# Statement of Guidance
# Internal Controls – Insurance

## 1. Statement of Objectives

1.1. To provide guidance on the requirement imposed on licensees by the Rule on Internal Controls.

1.2. To provide a standard of best practice to licensees for the implementation of an effective and sound Internal Control System.

1.3. Internal controls must be in place at the time of licensing an insurance company and are monitored primarily through the on-site inspection programme.

## 2. Management Control Culture and Oversight

2.1. The governance and control environment as established by the Board of the licensed entity either directly or by delegation in the case of managed entities, must set the culture and permeate every business activity and operational aspect of the company. The Board must demand a high level of control consciousness and expect every employee to contribute to its effectiveness.

2.2. The internal controls approved and applied should be adequate for the nature and scale of the business. Strengthening may be required as directed by the Authority at any time.

2.3. Operations

Internal controls should ensure effective and efficient operations, and should address the organisational structure in particular;

a) Duties and responsibilities including clear delegation of authority,

b) Decision-making procedures,
c) Separation of critical functions as far as can be reasonably undertaken (for example, sales and marketing, claims, reconciliation, risk management, accounting, audit, actuarial, and compliance).

2.4. Financial management

There should be clearly established accounting procedures, reconciliation of accounts, control lists and management information.

2.5. Insurance Activity

2.5.1 The Board of directors should oversee and review matters affecting the financial position of the entity, in particular, the implementation of its strategy for underwriting and pricing policies.

2.5.2 The Board of directors should approve and monitor internal controls for underwriting, valuation of technical provisions (policy liabilities), investment management, liquidity management, reinsurance and credit facilities.

2.6. Claims Handling

2.6.1 Insurance companies must establish and maintain controls that ensure the timely recording of adequate and accurate information regarding claims. This is to facilitate a proper assessment of the ultimate cost of all claims or potential claims that should then be recorded and monitored.

2.6.2 The following indicators of resource pressure should be regularly monitored:

a) Backlogs
b) Inactive files

c) Missed deadlines from any diary or equivalent record
d) Inaccuracies in case reserves or statistical reserves
e) Late or inappropriate amendments to reserves

2.6.3 Systems and processes should be in place to verify that management data is complete and accurate, and is being correctly recorded on a timely basis.

2.6.4 Controls are needed to ensure that as far as can be reasonably foreseen, adequate funding provision has been made to cover liabilities attaching to insurance contracts.

2.6.5 Controls also need to be in place to control expenses related to premiums and claims including claims handling and administration expenses.

2.7. Risk management

2.7.1 It is acknowledged that specific risk management practices may differ among entities depending upon the institution's size and the nature and complexity of its activities. However, a comprehensive risk management programme should deal with managerial and analytical techniques, including at a minimum:

a) good management information systems, and
b) business continuity planning.

2.7.2 Entities should identify and measure the operational risk inherent in all types of products, activities, processes and systems, including where activities and processes are outsourced

2.7.3 Entities should implement a system to monitor, on an on-going basis, operational risk exposures and loss events by major business lines.

2.7.4 Entities should have policies, processes and procedures to control or mitigate operational risk. They should assess the costs and benefits of alternative risk limitation and control strategies and should adjust their operational risk exposure using appropriate strategies, in light of their overall risk profile. In particular Internal controls should be in place to detect, prevent, record and report fraud and other irregularities within the entity. In addition, resource pressures should be monitored for its impact on management reporting and regulatory reporting. Also, there should be certain checks and balances at an adequately senior level that include;

a) The segregation of duties,
b) Applying the 'four eyes principle' i.e. checks by a second person,
c) Dual control of assets,
d) Use of double signatures,

2.8. Compliance

2.8.1 Internal controls should facilitate compliance with applicable laws, regulations, Rules, Statements of Guidance and Statements of Principle of the Authority, the Guidance Notes for the Prevention and Detection of Money Laundering in the Cayman Islands, industry codes of practice to which the entity has subscribed and the entity's own policies and procedures. In addition, the licensee should review whether its policies, practices and controls remain sufficient and appropriate for the business.

2.8.2 Management should ensure that adequate training suitable for the specific duties that management and staff members perform is provided initially and on an ongoing basis, including training relating to anti money laundering and combating the financing of terrorism and counter-fraud training. A licensee's training programme should ensure that staff possess or acquire appropriate and practical experience through "on-the-job" training and, where appropriate, structured courses.

2.8.3 Internal controls encompass the on-going internal audit function, which should be of a nature and scope appropriate to the business.

2.8.4 The internal audit function, if required, should;

a) Have unfettered access to all the entity's business lines and support departments;
b) Have appropriate independence, including reporting lines to the Board of directors and have status within the entity to ensure that senior management acts upon its recommendations;
c) Have sufficient resources and staff that are suitably trained and have relevant experience to understand and evaluate the business they are auditing;
d) Employ a methodology that identifies the key risks run by the institution and allocates its resources accordingly; and
e) Include the assessment of outsourced activities and processes.

2.8.5 Reports of the internal audit function made to the Audit Committee of the Board, or the Board itself where there is no such committee, should also be made available to the Authority.