GUIDELINES ON INVESTMENTS FOR INSURANCE COMPANIES

1. Preamble

These Guidelines known as the 'Guidelines on Investment for Insurance Companies' are effective from and shall be applied with immediate effect.

2. Objective

2.1. Every insurance company has an obligation to ensure that funds under its management are invested in a sound and prudent manner. These Guidelines set out the minimum policies that need to be observed in governance of investment management, management of investment portfolios and associated risks.

2.2. The Guidelines have been developed to achieve the following objectives:

2.2.1 To institute an effective and efficient governance of investment activities of an insurance company;

2.2.2 Ensure that insurance companies develop investment strategies and implement policies and procedures to execute the strategies at the operational level;

2.2.3 Ensure insurance companies develop appropriate risk management framework for identifying, monitoring and mitigating various risks arising from investment activities and that insurers control their investment portfolio effectively and efficiently;

2.2.4 Ensure insurers establish internal control mechanisms specifically with respect to investment activities.

2.3 The approach for investment management adopted by each insurer may vary depending on a wide range of factors including the size of the insurer's asset portfolio, nature of the insurer's business, level of complexity of the investment activities and available resources.

2.4 Regardless of the approach, basic principles such as accountability and role of the Board of Directors, Investment Committee and Senior Management (Investment), the need for a well defined investment policy, robust risk management policy and adequate monitoring and controls are applicable to all insurance companies.

3. Applicability of these Guidelines

These guidelines are applicable to all insurance companies registered in terms of the Regulation of Insurance Industry Act, No. 43 of 2000. (RII Act)

4. Governance of Investment Activities

4.1 An investment management framework to be supported by effective and efficient governance, which means, well defined role and responsibilities for the Board of Directors and Senior Management who are involved in the investment management.

4.1. Role and Responsibility of the Board of Directors

4.2.1 The Board of Directors shall exercise due care to ensure that the interests and rights of policyholders are not compromised at any time.

4.2.2 The responsibility for the formulation, approval, establishment and implementation of investment policy, internal controls & operational guidelines, risk management procedures must rest ultimately with the Board of Directors.

4.2.3 The Board shall ensure that Senior Management reviews the investment policy, strategies and procedures periodically as and when required by the Board.

4.2.4 At least once annually, the Board of Directors shall review the adequacy and relevance of the investment policy of the insurer in terms of overall risk tolerance, long term risk-return requirements and solvency position in light of the insurer's activities and risk profile.

4.2.5 The Board shall ensure that the investment management operations and risk management is handled by competent and experienced persons who will conduct their duties in a professional manner with integrity (whether in-house or outsourced). The Board shall take steps to minimize operational risk.

4.2.6 The Board should decide if and when expert external advice is necessary and seek same when required.

4.2.7 The Board members should have a clear understanding of the investments in which the insurer seeks to invest, including their characteristics and related risks.

4.2.8 The Board should examine the reports on the quality and performance of the investment portfolio.

4.3 Role and Responsibility of Senior Management

4.3.1 Develop the institution's investment policy, recommend its approval by the Board of Directors and ensure implementation.

4.3.2 Develop and implement the investment strategies.

4.3.3 Implement and maintain adequate risk management systems, procedures and controls in respect of the investment activities of the insurer. These shall include, but not be limited to, ensuring that:

a) Proper segregation of execution, monitoring and performance measurement functions;

b) The authority of persons entering into, performing or otherwise dealing in investments for and on behalf of the insurer, and limits of such authority, are clearly delineated;

c) Proper performance monitoring procedures;

d) Continuous risk monitoring procedures;

e) Proper computer systems, software are in place to conduct and monitor the investment function efficiently;

4.3.4 Periodically analyze and assess the quality and performance of individual investments as well as the overall portfolio and report to the Board & Investment Committee on a regular basis and upon request.

4.3.5 Establish internal control mechanisms to ensure that investments comply with the institution's policies and procedures and with legal and regulatory requirements.

4.3.6 Periodically review the internal controls & operational guidelines, risk management procedures and recommend any amendments to the Investment Committee.

4.3.7 Review the performance of the fund managers/investment staff (internal/out sourced) and report same to the Investment Committee.

4.4 Investment Committee

4.4.1 For the purpose of the insurer's investment activities, the Board of Directors shall establish a committee (the "Investment Committee") that may include Independent Directors, Principal Officer and Chief Investment Officer (or an officer in a similar capacity responsible for the investment functions). Considering the nature of long term insurance business there is a greater need for involvement of the Actuary in review of investment policy and strategies. In case of a General Insurance Company, insurer should use actuarial advice on investment-related matters for which the actuary's expertise and experience would be useful.

4.4.2 The Investment Committee shall report regularly to the Board of Directors.

4.4.3 The Board of Directors delegates authority to the Investment Committee to make investment decisions on its behalf, the Investment Committee shall report to each meeting of the Board on any and all decisions of material consequence made since the last meeting of the Board of Directors.

4.4.4 In addition to the above reports, the Investment Committee shall also prepare reports for the Board of Directors, as and when any investment related activity of material consequence arises, with details of the various issues and the impact on the funds and the insurer.

4.4.5 The Investment Committee shall ensure that a Board approved investment policy of the insurer is implemented in an appropriate manner.

4.4.6 It shall ensure that reports on investment activities are prepared in a timely manner for consideration on behalf of the Board of Directors so that it can provide general oversight of the investment policy of the insurer.

4.4.7 To report to the Board of Directors any breaches and concerns regarding the internal controls, investment operations and risk management procedures.

4.4.8 The duties delegated to the Investment Committee shall include, but not be limited to the following functions:

a) To review the investment policy of the insurer on a regular basis so that it remains appropriate, recognizing among other things, changes in business in force and the economic environment;

b) To ensure the investment policy of the participating fund in case of long term insurance business is consistent with the bonus and/or dividend policy of the insurer;
c) To ensure resources dedicated to the investment activities of the insurer are sufficient to implement and manage the approved investment policy and any other activities requested by the Board of Directors;
d) To review the adequacy of internal control systems to support investment activities;
e) To review the adequacy of risk management systems to support prudent investment management.

4.5 The insurer shall ensure that it has a Board approved Asset Liability Management (ALM) policy which explicitly takes into consideration its investment management and product development and pricing functions.

4.6 The ALM policy shall be appropriate to the nature, scale and complexity of the risks associated with the insurer's assets and liabilities.

4.7 An insurer shall ensure that its ALM policy:

a) Recognizes the interdependence between the insurer's assets and liabilities and take into account the correlation of risk between different asset classes as well as the correlation between different products and business lines;

b) Takes into account any off-balance sheet exposures that the insurer may have and the contingency that risks transferred may revert to the insurer.

4.8 Where relevant, the ALM policy shall include the following:

a) How the investment and liability strategies adopted by the insurer allow for interaction between assets and liabilities;
b) How the liability cash flows are met by the cash inflows;
c) How the economic valuation of assets and liabilities are changed under an appropriate range of different scenarios;

5 Investment Policy

5.1 All insurance companies are required to have written investment policy approved by its Board of Directors which shall be available to all parties carrying out investment activities.

5.2 Insurers are required to maintain separate funds as stipulated in the 'Guidelines on Management of Insurance Funds'. The investment policy may differ between different funds depending on the fund requirements / objectives.

5.2.1 Long term insurers to ensure the investment policy of the participating fund, universal life fund, linked long term funds, is consistent with the bonus & dividend policies of the insurer, policyholder expectations, protecting policyholder interest, asset limits informed to policyholders.

5.3 The investment policy should incorporate the following elements:

5.3.1 Determination of the strategic asset allocation for each of the major insurance funds, that is, the long term asset mix over the main investment categories.

5.3.2 This shall be done with due regard to Asset-liability management, Overall risk tolerance, Long term risk-return requirements, Solvency position and liquidity requirements of the insurer etc.

5.3.3 Establishment of limits for the allocation of assets suitably. For example: geographical area, markets, sectors, counterparties and currency.

5.3.4 Formulation of an overall policy on the selection of individual securities and other investment titles.

5.3.5 Adoption of passive or more active investment management in relation to each level of decision making.

5.3.6 In the case of active management, definition of the scope for investment flexibility, usually through the setting of quantitative asset exposure limits.

5.3.7 The extent to which the holding of some types of assets is ruled out or restricted where, for example, the disposal of the asset could be difficult due to the lack of liquidity of the market or where independent (i.e. external) verification of pricing is not available.

5.3.8 Maintain proper books of account relating to each insurance fund and shareholders' fund and establish the framework of accountability for all asset transactions; these have to be audited at least yearly.

5.3.9 Policy for safe-keeping of assets, including custodial arrangements and the conditions under which investments may be pledged or lent.

6. Monitoring and Controls

6.1 An insurer should establish management practices to properly monitor and control investments (both individually and portfolio bases) in effective and efficient manner.

6.2 Monitoring comprises following components-

- **Understanding risks associated with each investment activity**

6.2.1 Before making any investment, the insurance company should understand the source, scope and types of risks associated with an investment activity.

6.2.2 Risks associated with investment activities may affect the coverage of policy liabilities and capital positions of the company and primarily includes market, credit and liquidity risks.

6.2.3 Consideration should be given to the interrelationships and interdependencies between the risks.

6.2.4 Adequate methods should also be used to measure the risk exposure and establish techniques for mitigating risks.

6.2.5 Reporting mechanisms should be established so that the risks encountered are clearly communicated, known and understood by all parties within the insurer who are involved in its investment activities.

6.2.6 The institution should remain prudent with respect to any analysis conducted by rating agencies.

- **Portfolio quality and performance**

6.2.7 The institution should analyze and assess its portfolio on a regular basis and as needed to ensure the quality and performance of its investments.

6.2.8 It should ensure that the investments and the positions taken with respect thereto meet its objectives and are in line with its investment risk tolerance levels.

6.2.9 The insurer should be able to draw on reliable and efficient information systems for such purpose.

- **Concentration limits and diversification**

6.2.10 Concentration limits should be set in light of the institution's capital requirements and should cover its exposures, in particular in respect of issuers and counterparties.

6.2.11 These limits could be expressed in relation to the different parameters, for example:

a) Types of investments and their attributes (including risk/returns, maturities, whether secured by claims, rank in the event of winding-up, dividend policy, conversion feature)

b) Liquidity and negotiability of the securities; industry sectors;

c) Counterparties, such as public issuers, private issuers, affiliated legal persons and associates of a director and the institution;

7. Other Internal Controls

7.1 The insurer should ensure that certain investment processes remain independent, including with respect to the front office, the back office and the risk management functions, while also avoiding decision-making by a single person.

7.2 The extent and nature of internal controls adopted by each insurance company may be different but the following procedures should be considered:

7.2.1 Identification of personnel who are responsible and accountable for;

7.2.2 All transactions involving sales and purchase of assets;

7.2.3 Observations of restrictions on the empowerment of all parties to enter into any particular transaction. This will require close and regular communication with those responsible for compliance, legal and documentation issues in the insurance company;

7.2.4 Formal documentation is completed promptly;

7.2.5 All transactions are carried out in conformity with prevailing market terms and conditions;

7.2.6 Authority and dealing limits are strictly enforced and all breaches are reported and remedial actions are taken promptly;

7.2.7 Independent checking of rates or prices and choice of rates should not solely rely on dealers for rate/price information;

7.2.8 Set out the process for recommending, approving, and implementing decisions;

7.2.9 Prescribe the frequency and format of reporting to relevant internal and external authorities.

7.3 An insurance company should describe the method for classifying investments and the basis for valuing investments including those that are not regularly traded. While the Board of Directors are responsible to ensure compliance with accounting standards and regulatory requirements related to assets, the impact of same on investment strategy and results should be carefully considered.

7.4 An insurance company should put in place rigorous audit procedures that include full coverage of the investment activities that enable timely identification of internal control weaknesses and operating system deficiencies.

7.5 If the audit is performed internally, insurance company must ensure that:

7.5.1 It should be independent of the function being reviewed;

7.5.2 Audit plans are endorsed by the Audit Committee of the Board of Directors;

7.5.3 Audit report to the Board of Directors should assess compliance with the overall investment policies and procedures;

7.5.4 Internal auditors are equipped with the requisite level of skills and competencies in investment risk management.

7.6 Internal control shortcomings and material investment compliance deficiencies should be noted and reported to Senior Management and the Board of Directors. Appropriate follow up should be performed and the necessary measures should be taken in a timely manner.

8. Related party investments

8.1 Related party investments should comply with applicable regulatory limits/requirements and all transactions are entered at arm's length basis. However these transactions shall only be made and entered into, substantially on terms and conditions not less favourable than those with other investments of comparable risks.

8.2 Related party transactions shall require the approval from the Investment Committee.

8.3 If an actual or potential conflict of interest arises on the part of a Investment committee member or Senior management member, he is mandated to fully and immediately disclose the same and should not participate in the decision – making process relating to the transaction.

8.4 Any member of the Board who has an interest in the transaction under discussion shall not participate therein and shall abstain from voting on the approval of the transaction

9 Outsourcing of Investment activities

9.1 Where the investment management activities are outsourced to a third party, insurers must ensure that the outsourced entity is being engaged under a contract that, inter alia, sets out the policies, procedures and limits of the investment mandate.

9.2 The policies, procedures and limits for the outsourced funds must meet the same objective of the insurers' investment policies, strategies and procedures.

9.3 Insurers' must establish comprehensive policies and procedures to govern the investment policy of the funds outsourced, establish an effective risk management system to monitor and continuously assess material risks and for the insurer funds to be kept separately and not commingled with other funds managed by the outsourced entity.

9.4 Insurers' must regularly monitor the performance of the outsourced entity, at least semi-annually and take appropriate actions if the investment performance of the outsourced entity would adversely affect the investment returns to policyholders' or if participants' reasonable expectations cannot be achieved.

10 Supervision

10.1 To foster the establishment of sound and prudent management practices within insurers, the IBSL, acting within the scope of its supervisory activities, intends to assess

10.1.1 The degree of compliance with the principles set forth in this guideline in light of the specific attributes of each insurer.

10.1.2 Consequently, it will examine the effectiveness and relevance of the policies, strategies and procedures adopted by the insurer as well as the quality of oversight and control exercised by their Board of Directors and Senior Management of insurers.

10.1.3 Investment management practices are constantly evolving. IBSL therefore expects decision makers to remain current with best practices and to adopt such practices, to the extent that they address their needs.