INSURANCE SUPERVISION DEPARTMENT

INVESTMENT GUIDELINES

ISSUED UNDER THE AUTHORITY OF PART I, SECTION 7(D) OF THE INSURANCE ACT 2016 (ACT NO. 17 OF 2016)

Bank of Guyana
23 May 2018

INVESTMENT GUIDELINES
INSURANCE SUPERVISION DEPARTMENT - BANK OF GUYANA

1.0 Authorisation

IN EXERCISE of the powers conferred by section 7(d) of the Insurance Act 2016, the Bank of Guyana (herein referred to as the Bank) issues the Guideline set out here below, for observance by all registered insurers in respect of the management of investments.

2.0 Introduction

2.1 Investments are an important part of an insurer's assets and a considerable source of its income.

2.2 Where investments are not managed properly, this can lead to losses thus threatening an insurer's financial soundness and can cause major liquidity problems.

2.3 In order to protect policyholders, it is therefore essential that insurers apply sound and prudent investment management practices. It is important that the Board of Directors and management of insurance companies, in carrying out their obligations, exercise the care, diligence, and skill that a reasonably prudent person would apply in respect of a portfolio of investments, to avoid undue risk of loss and obtain a reasonable return, and which appropriately reflects the liability structure of the insurer. These responsibilities are specifically referenced in Section 63(h) of the Insurance Act 2016.

2.4 Investment Regulations under the Insurance Act set out limits and restrictions relating to investment with which insurance companies must comply. The Bank considers that these limits are to be regarded as a minimum standard and that the internal policies of financial institutions should be more stringent, depending on the institution's liability structure, risk profile and risk tolerance levels to maintain a sound financial operation.

3.0 Objectives

3.1 The purpose of this guideline is to ensure that the assets of insurers are managed in a manner that is consistent with its risk profile, liquidity needs and liability profile. More specifically, in the management of investments the insurer's board of directors and senior management should take account of the security, liquidity and diversification of the overall portfolio of investments. Investments should be sufficiently secure and should be designed to facilitate payments to policyholders and creditors as they fall due. Investments should be held in a physical location which will ensure their availability as required.

3.2 This guideline sets out the expectations of the Bank regarding investment management practices which are consistent with international best practices and Insurance Core Principles issued by the International Association of Insurance Supervisors.

3.3 This guideline seeks to highlight guiding principles which the Bank views as critical to the insurer in establishing sound and prudent investment management practices.

3.4 The investments shall be made in a sound and prudent manner. Insurers are required to have due regard for the following basic investment parameters:

a. **Security –**Insurers shall invest in assets that appropriately ensure preservation of capital.

b. **Liquidity –** Insurers shall invest in assets that can easily be disposed of without affecting the price.

c. **Diversification**–Insurers shall invest assets in a wide range of instruments so as to spread the risk.

d. **Return**–Insurers shall invest assets in instruments that generate high income whilst considering the associated risks.

Principle 1: Governance Structures

4.0 Insurers shall develop an investment management framework which is supported by effective and efficient governance.

4.1 Board of directors[1]

4.1.1 The roles and responsibilities of the Board of Directors with regard to an insurer's investment management shall be as follows:

- Participate in examining[2] and approving the investment strategy and ensure it is implemented.

- Examine and approve the investment policy, while ensuring that senior management reviews the policy periodically and when required.

- Ensure that the investment management is handled by competent and experienced persons of integrity.

[1] A reference to the board of directors can also include a board committee, such as the Investment Committee established to examine specific issues.
[2] This should be done on an annual basis, at minimum.

- Examine the reports on the quality and performance of the investment portfolio. The board members should have a clear understanding of the investments in which the insurer seeks to invest, including their characteristics and related risks.
- The board should be provided with a periodic report showing the insurer's compliance situation with regard to each of the constraints and limits contained in the Investment Regulation.

- Satisfy itself that there has been appropriate management follow-up of any activities, transactions or situations that appear to the board to be irregular or problematic. Ensure that satisfactory internal control mechanisms are in place.

- Specify the content and frequency of investment management reports to be submitted to the board.

- Where the investment function is outsourced, the board shall bear the ultimate responsibility for ensuring compliance with the regulations and this guideline.

4.1.2 The board's examination could consider the following aspects, among others:

- changes in the investments and their performance in light of market trends and the insurer's risk profile;

- major investment positions taken as well as the depreciation and write-off of investments; and

- investments issued or guaranteed in connection with transactions between affiliated legal persons or associates as they could constitute a source of conflict of interest.

- In any case, where the board's examination of the investment function reveals material continuing situations of non-compliance with the investment regulation or this guideline, the board should report to the Bank, outlining the nature of the non-compliance and the actions that have been instituted or are being instituted by the insurer to rectify the situation.

4.2 Senior Management

4.2.1 The roles and responsibilities of senior management with regard to an insurer's investment management are:

- develop and implement the investment strategy; - develop the insurer's investment policy, recommend its approval by the board of directors and ensure that it is implemented;

- develop and implement procedures with respect to investment activities;

- periodically analyse and assess the quality and performance of individual investments as well as the overall portfolio, and report to the board on a regular basis and upon request;

- follow-up of any activities, transactions or situations that have been noted by the board as seeming to be irregular or problematic.; and

- establish internal control mechanisms so as to ensure that investments comply with the insurer's policy and procedures and with legal and regulatory requirements.

4.3 Investment Managers

4.3.1 Where an insurer uses services of investment managers, the manager shall be qualified and competent to carry out the assigned task.

4.3.2 Senior management and the board shall monitor the work of investment managers to ensure that the insurer's strategy is being adhered to.

4.4 Risk Management Function

4.4.1 Typically insurers will be expected to follow what is known as the "three lines of defence" model. The business unit is considered to be the first line of defence, the control functions (other than internal audit) are considered to be the second line of defence, and internal audit is the third line of defence. The business unit is deemed to "own" the controls, and the other lines of defence are there to help ensure their application and viability.
The roles and responsibilities of the risk management function with regard to an insurer's investment management are:

- monitor adherence to the approved investment policy and regulatory obligations;

- formally note and promptly report to the board of directors any breaches or "near misses" (which may in turn dictate amendments to the insurer's stress testing regime);

- review risk management activities with regard to investment; and

- ensure that the investment strategy is aligned with the overall risk management policy of the insurer.

4.4.2 Information systems should be configured to enable timely and accurately reporting to management. The insurance company should develop comprehensive, accurate and flexible systems, which allow the identification, measurement and assessment of investment and lending risks, and the aggregation of those risks at various levels as appropriate. Such systems will vary among institutions, but should be sufficiently robust to reflect the nature of the risks and the extent of the investment activity undertaken.

4.5 Audit

4.5.1 Insurers shall conduct an audit of their investment activities which ensures timely identification of internal control weaknesses and deficiencies in the management information systems.

4.5.2 Where the audit is performed internally, it must be independent.

4.5.3 The roles and responsibilities of the internal audit function with regard to an insurer's investment management are:

4.5.3.1 Evaluate the independence and effectiveness of the insurer's investment management functions;

4.5.3.2 Periodically review the insurer's asset portfolio to ensure that it is consistent with the insurer's investment policies and procedures as well as regulatory obligations;

4.5.3.3 Monitor adherence to the approved investment policy and regulatory obligations;

4.5.3.4 Give assurance that the insurer's investments are secure and are made and kept in the name of the insurer;

4.5.3.5 Assess the effectiveness of the internal controls.

4.6 Internal controls

4.6.1 Insurers shall design and implement effective internal controls.

4.6.2 Insurers shall establish adequate systems of internal control to ensure that assets are managed in accordance with the overall investment policy, and the legal and regulatory requirements. Key controls include but are not limited to segregation of duties, approvals, verifications and reconciliations.

4.6.3 Internal controls with respect to investment include:

4.6.3.1 concentration limits;

4.6.3.2 valuation and recording of investments in accordance with generally accepted accounting principles. Special attention should be paid to investments used for arbitrage trading and hedging purposes;

4.6.3.3 responsibilities of depositories and the terms and conditions of custodial arrangements;

4.6.3.4 cash flows generated through investments such as income, repurchases and redemptions at maturity;

4.6.3.5 reporting on investments;

4.7 Reporting

4.7.1 Regular and timely reports of investment activities should be produced for review by the Board of Directors and senior management of the insurer. These reports should describe the exposure in clearly understandable terms and include quantitative and qualitative information.

4.7.2 The frequency of reporting to the Board by senior management should be commensurate with the complexity and risks inherent in the institution's investment portfolios. Reports to the Board should provide adequate information to judge the changing nature of the insurer's investment profiles, the risks that arise and the consequences for the insurer.

4.7.3 More frequent reporting should be required for problem investments, which represent, or have the potential to represent, a significant adverse impact to the insurer.

Principle 2: Strategy, Policy and Procedures

5.0 Insurers shall have in place an investment strategy and implement policy and procedures to execute the strategy at the operational level.

5.1 The Investment Management

5.1.1 An insurer shall, in managing its investments, have the following in place:

5.1.1.1 An investment strategy and policy;

5.1.1.2 Systems that allow the identification, measurement and assessment of investment risks and the aggregation of these risks at different levels;

5.1.1.3 Adequate procedures for the measurement and assessment of investment performance;

5.1.1.4 Adequate and timely internal communication of information on investment activities;

5.1.1.5 Procedures to identify and control the dependence on and vulnerability of the insurer to key personnel and systems;

5.1.1.6 Procedures with regard to the delineation and implementation of any changes of the investment strategy;

5.1.1.7 Internal controls, such as segregation of duties, approvals, verifications and reconciliations;

5.1.1.8 Internal procedures to review the appropriateness of the investment policies and procedures;

5.1.1.9 Rigorous and effective audit procedures and monitoring activities to identify and report weaknesses in investment controls and compliance.

5.2 Investment Strategy

5.2.1 Insurers shall develop an investment strategy that is in line with the operational objectives, plans, organisational structure and appropriate control measures.

5.2.2 The investment strategy should allow the insurer to:

- develop a policy and implement the procedures necessary for the insurer to achieve sound investment management; and

- aim for a risk/return balance based, in particular, on its business lines and its risk appetite. To this end, the insurer shall regularly determine and revise the investment risk tolerance levels based on its objectives.

5.2.3 An insurer shall take the following into consideration when developing an investment strategy:

5.2.3.1 insurer's risk appetite and tolerance levels;

5.2.3.2 the scope of investment risks, including market risk, insurance risk, credit risk, liquidity risk and operational risk;

5.2.3.3 capital and solvency requirements;

5.2.3.4 details of the insurer's investment selection criteria, standards and other parameters including the asset allocation mix across investment categories;

5.2.3.5 conditions governing the mortgaging or lending of the insurer's assets and guidance for such arrangements;[3]

5.2.3.6 any restrictions or prohibitions on the acquisition of certain investments deemed to involve greater risks or are subject to high volatility;

[3] Subject to section 78 of the Insurance Act, no insurer has the power to borrow, other than managing credit balances in the normal course of business, nor to pledge any assets of the Statutory Fund for any purposes whatsoever (Section 77).

5.2.3.7 the extent to which the insurer's investments can be diversified including alternate risk mitigating strategies;

5.2.3.8 the company's policy on the use of financial derivatives and other structured products;[4]

5.2.3.9 accountability for all investment transactions; and

5.2.3.10 investment authorisation criteria and limits.

5.2.4 The investment strategy shall be reviewed regularly and as needed, particularly in light of changes in the capital markets, the development of new financial products and the insurer's commitments to the policyholders.

5.3 Investment Policy

5.3.1 An insurer's investment policy shall establish the principal parameters within which the insurer should manage its investment activities. The policy should be sufficiently supported to ensure effective management, particularly in respect of situations where the risk is considered to be high.

5.3.2 In light of the investment strategy developed by the insurer, the investment policy shall address the following elements, at a minimum:

5.3.2.1 insurer's risk appetite and tolerance levels;

5.3.2.2 types and characteristics of the investments;

5.3.2.3 expected returns and the purpose of the investments, such as liquidity, matching, pledging of collateral, hedging and trading;

5.3.2.4 investment concentration limits;

5.3.2.5 investments decision criteria, standards and other parameters;

5.3.2.6 processes relating to intra-group management of investment activities;

5.3.2.7 procedures for analysing and evaluating investments when deciding to make an investment and when carrying out a transaction;

5.3.2.8 where applicable, the ratings of international rating agencies; and

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[4] Ibid

5.3.2.8 monitoring and control of investments;

5.3.2.9 accountability for all investment transactions; and

5.3.2.10 investment authorisation criteria and limits; and

5.3.2.11 asset liability matching.

5.4 Asset Liability Management (ALM)

5.4.1 Insurers shall hold sufficient assets to support their liabilities including technical provisions and capital requirements.

5.4.2 Insurers shall develop an Asset Liability Matching (ALM) policy. The policy shall be appropriate to the nature, scale and complexity of the insurer's operation.

5.4.3 Insurers shall invest in portfolios well diversified across different asset classes and within a particular asset class. Investment decisions should be guided by portfolio perspective rather than individual asset-return/ risk characteristics.

5.4.4 Insurers shall have in place effective procedures for monitoring and managing their asset/liability positions to ensure that their investment activities and asset positions are appropriate to settle their liabilities when they become due.

5.5 Procedures

5.5.1 An insurer shall develop and maintain documented investment procedures that are subject to effective oversight.

5.5.2 The investment management procedures shall allow an insurer to manage its investment activities properly, particularly with respect to acquisitions or disposals.

5.5.3 Investment decisions shall be based on analyses and valuations that take into account in particular the insurer's investment risk tolerance levels and expected returns. This should be supported by full documentation.

5.5.4 An insurer shall evaluate and understand the source, scope and types of risks associated with an investment activity. Adequate procedures shall be implemented to manage investment risks, while giving consideration to the interrelationships and interdependencies between the risks to which the insurer is exposed. Adequate methods should be used to measure the insurer's risk exposure and establish techniques for mitigating the risks.

5.5.5 An insurer shall consider various internal and external factors that are likely to affect the risks it is exposed to, its risk tolerance levels, its objectives, the general economic climate, interest rates, legal and regulatory requirements.

5.5.6 An insurer shall establish reporting mechanisms so that the risks encountered are communicated to all parties involved in its investment activities.

5.5.7 An insurer shall determine the value of its investments in an objective manner and ensure that the information used to do so is reliable.

5.5.8 An insurer shall establish investment analysis tools particularly on the following elements:

- nature, characteristics and liquidity of the investments; and
- degree of exposure to various risks for each type of investment and for the investment portfolio as a whole, particularly in light of concentration limits.

5.6 Concentration Limits

5.6.1 An insurer shall set concentration limits in light of its capital requirements and shall cover all its exposures, in particular with respect to issuers and counterparties.

5.6.2 The concentration limits could be expressed in relation to the following parameters, among others:

5.6.2.1 types of investments and their attributes, including risk, returns, maturities, security, subordination, conversion features, complexity;

5.6.2.2 liquidity and transferability of the securities;

5.6.2.3 geographic zones and industry sectors; and

5.6.2.4 counterparties.

Principle 3: Intra-group management

6.0 Insurers shall manage investments in accordance with the framework established for the group.

6.1 Where an insurer is part of a group, investment procedures shall be established for the insurer and the entities within the group.

6.2 The procedures shall cover certain situations that could entail greater risks for one or more entities within the group, or for the group as a whole.

6.3 All the previous items of this Guideline that are applicable to the insurance company, are also applicable *mutatis mutandis* to the insurer's interactions from the group level perspective. More specifically, the insurer shall manage its investments in accordance with the framework established for the group, as set out within these Guidelines stated herein.

Principle 4: Monitoring and control of investments

7.0 Insurers shall monitor and control their investment portfolio effectively and efficiently.

7.1 An insurer shall establish management practices to properly monitor and control its investments both individually and on a portfolio basis.

7.2 An insurer shall put in place adequate systems of internal control to ensure investment activities are supervised.

7.3 An insurer shall analyse and assess its portfolio on a regular basis to ensure the quality and performance of its investments.

7.4 An insurer shall adjust and monitor the selection of investments, particularly when material discrepancies arise with respect to actual versus expected returns or a significant change takes place regarding the risk associated with one or more investments.

7.5 An insurer shall ensure that the investment portfolio is diversified to mitigate investment risks.

7.6 Insurers shall prepare regular and timely reports which describe the company's exposure. Reports should include:

7.6.1 details of, and comments on, investment activity during the period and comparison with corresponding previous period;

7.6.2 details and values of invested asset by type;

7.6.3 an analysis of credit exposures by counterparty;

7.6.4 the insurer’s compliance situation with regard to each of the constraints and limits contained in the Investment Regulation along with details of any regulatory or internal limits breached in the period and the actions taken thereto;

7.6.5 status of asset-liability matching;

7.6.6 planned future activity; and

7.6.7 details of the position of assets and liabilities.

Principle 5: Supervisory Oversight

8.0 Enforcement

8.1 The Bank's monitoring process comprises off-site surveillance and on-site risk based examination to ensure that insurance companies have adequate systems, policies and procedures to identify, measure, control, and report the risks in their investment portfolios. In addition, the Bank would routinely check for compliance with statutory limits and/or restrictions.

8.2 The Bank may from time to time introduce reporting requirements on the investment portfolios in pre-determined frequency and format. The accuracy of this reporting would be periodically verified by the Bank.

8.3 The Bank's evaluation of the investment and lending programmes will also include analysis of the risk profile, composition, and quality of the investment portfolios and their impact on the insurer's earnings and condition.

8.4 The Bank's overall risk assessment of an insurer will to a material degree, take account of the effectiveness of the systems, policies and procedures applicable to its investment operations.

8.4 The Bank may restrict or prohibit an insurer from investing in certain asset classes or individual assets to safeguard insurance funds.

8.5 Such restrictions or prohibitions will form part of supervisory actions as a result of the Bank's assessment of an insurer's risk profile and investment risk management function.

9.0 Effective Date

The effective date for this Guideline is 23 May 2018.