RISK BASED SUPERVISION FRAMEWORK
For Insurance Companies

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1.0 INTRODUCTION

1.1 ICB’s Mandate

The Insurance Commission of The Bahamas (ICB) was established in 2009 to supervise the insurance industry in The Bahamas. The ICB is responsible for regulating and supervising all insurance activities in and from The Bahamas. This includes licensing, regulating and supervising insurers (including domestic and external insurers), and insurance intermediaries.

ICB’s mandate in respect of insurers is:

Protect policyholders' interests by ensuring financial soundness of insurers operating in and from The Bahamas

Protect policyholders

Promote stable insurance

Promote systemic stability of and confidence in the insurance industry in The Bahamas

Promote fair treatment of customers of services and products offered by insurers in The Bahamas

Promote systemic stability of and confidence in the insurance industry in The Bahamas

Promote fair treatment of customers

Promote stable insurance

Promote systemic stability of and confidence in the insurance industry in The Bahamas

Promote fair treatment of customers of services and products offered by insurers in The Bahamas

1.2 Achieving ICB’s Mandate

The ICB meets its mandate through a program of regulation, supervision and market conduct of registered insurance entities. Regulation involves the development, consultation, introduction and enforcement of appropriate legislative and regulatory requirements for insurers, including authorizing and licensing insurers to operate in and from The Bahamas.

This supervisory framework outlines the ICB’s supervisory methodology and involves continuous assessments of insurers. This is an assessment of the safety and soundness of the insurer and compliance with legal and regulatory requirements. It includes intervening effectively on a timely basis in cases where prudential issues or concerns are identified. It also includes oversight of insurer's market conduct processes and practices. The ICB has a program of licensing, regulating and supervising intermediaries that is not specifically addressed in this Framework. However, where intermediaries are part of a financial group, they would be included in group-wide supervision. Also, the risk based supervisory approach is applicable to insurance intermediaries.

Since its establishment in 2009, ICB has updated the legislation and regulations governing insurers and completed re-registration of all insurers under the requirements of the updated regulatory framework. The ICB is a member of the International Association of Insurance Supervisors (IAIS) and subscribes to the Insurance Core Principles (ICP), standards and guidance of the IAIS.

1.3 ICB’s Supervisory Framework

The supervisory framework is a risk-based structured methodology designed to facilitate proactive and dynamic assessment of insurers regulated by ICB. It is outcome focused with sufficient flexibility
to enable ICB to identify and respond to new and emerging risks through an integration of macroeconomic and industry perspective in the assessment of individual insurers.

The framework provides a structured approach for understanding and assessing key risks inherent in an insurer’s activities, whether its risk management processes (i.e. identification, assessment, measurement, monitoring, controlling, mitigating and reporting of risks) are adequate in the context of the key risks and whether its earnings, capital and liquidity are sufficient to enable it to support its risk profile and withstand unexpected shocks.

ICB’s supervisory methodology is consistent with the “Insurance Core Principles Methodology” of the International Association of Insurance Supervisors.

1.4 ICB’s Supervisory Approach

The following are the key principles governing ICB's supervisory approach:

1. It is risk-based, forward-looking and outcome focused.

2. It recognizes that Board of Directors and Senior Management of insurers are primarily responsible for the financial soundness and prudent management of the insurer.

3. It is intended to reduce the risk of failure or inappropriate behavior by insurers; but, it cannot prevent all failures as that would result in excessive regulatory burden for the industry and could negatively impact its efficiency.

4. The supervision of insurers is conducted on a consolidated basis, using information from other regulators as appropriate.

5. The exercise of sound judgment in identifying and evaluating risks is central to the effectiveness of the supervisory framework.

6. The level and frequency of supervisory scrutiny and the degree of intervention depends on the risk profile of the insurer.

7. Where appropriate, ICB leverages the work of the insurer’s Corporate Governance and Oversight functions to minimize duplication of effort.

8. Communication of assessments and recommendations to insurers are risk focused and timely.

9. ICB relies on external auditor’s opinion with respect to the fairness of the financial statements and uses their work to modify the scope of its reviews to minimize duplication of effort. Similarly, ICB relies on actuaries for the adequacy of policy liabilities and uses their work to modify the scope of its work as appropriate.

1.5 Benefits of ICB’s Supervisory Approach

The key benefits of the supervisory approach are:

1. Focus on early identification of emerging risks to facilitate timely interventions through integration of macro and micro prudential supervision;

2. Assessments parallel how an insurer is managed and can leverage an insurers corporate governance, risk management and oversight;

3. Better evaluation of risk through separate assessment of inherent risks and risk management processes resulting in a deeper understanding of an insurer's operations, its risk appetite and
the key drivers of its risk profile;
4. Early identification of problem insurers and areas in an insurer with prudential issues and concerns;
5. Cost effective utilization of resources through sharper focus on risks;
6. Reporting risk focused assessments to insurers to promote good practices;
7. Reducing regulatory burden on well managed insurers;
8. Encouraging a strong risk management culture in insurers; and
9. Providing flexibility for supervisors to use professional judgment within a structured process.
2.0 INTEGRATING MACRO AND MICRO PRUDENTIAL SUPERVISION

2.1 ICB’s Supervisory Methodology

The operations of financial institutions are increasingly more connected with each other and with other segments of the economy. Consequently, effective supervision of insurers requires an understanding and an assessment of the broader economic and industry environment in which the insurer operates.

ICB’s supervisory methodology looks beyond individual insurers. It adopts a stronger macro prudential perspective with a focus on specific risk areas and supervisory themes, without detracting from the supervision of individual insurers. This enables it to identify, monitor, and analyze, market, financial and other material environmental factors and developments that could impact an insurer, the insurance industry and other financial sectors.

Methods of introducing macro prudential supervision factors include surveillance of the broader economic environment and the industry to identify emerging trends and vulnerabilities, as well as peer comparisons of individual insurers. Through this process, supervisors also engage management of insurers in a discussion of risks facing their institution as well as their views on risks in the industry and the broader operating environment. It also includes regular exchange of information and assessments with the banking and securities regulators in The Bahamas; informing macroeconomic and policy decisions of the Government.

Identifying and monitoring macro prudential risk factors in an insurer’s operating environment is an important element of the methodology. This requires monitoring of factors such as level of economic activity, financial market indices, level of interest rates – current and projected, projected rates of inflation, level of court awards, availability of investment products, catastrophes, pandemics, etc. By monitoring the more important macro prudential factors, supervisors are able to assess their probable impact on the industry as well as for individual insurers.
The assessment aims at establishing a dynamic approach to identifying potential risks and vulnerabilities. It enables supervisors to link activities and risks of individual insurers to the insurance industry and the wider financial system and vice versa. This assessment process is iterative.

### 2.2 Industry Risk Factors

Industry analysis is based on periodic information filed by insurers with ICB (including underwriting, profitability, assets, liabilities, capital positions, etc) as well as on industry information gathered from other sources such as industry publications, rating agencies and meetings with company management.

Supervisors consider factors such as;

1. Trends and experience on products and services offered by lines of business;
2. Exposures to catastrophes;
3. Underwriting capacity;
4. Availability, use and cost of reinsurance;
5. Level of deficiencies experienced on reserves;
6. Level of competition;
7. Availability of required skilled resources;
8. Investment trends;
9. Rate of return on investments;
10. Capital levels; and
11. Experience in external markets on business written from The Bahamas.

The analysis done on a comparative basis provides supervisors with an understanding of industry experience and trends, as well as risks faced by the industry and system-wide vulnerabilities.

The analysis provides a macro industry level input into the supervisory process and equips supervisors to assess individual insurers in the context of the industry, supported through peer comparisons.

### 2.3 Insurer's Business Model and Strategy

To understand the business profile of an insurer, supervisors need to understand its business objectives, strategies to achieve its objectives, and organization and accountability structures used.

A supervisor needs to understand how the insurer plans to achieve its objectives, and the activities it engages in or plans to engage in. It is also important to understand the insurer's risk tolerance as well as the insurer's track record in executing its strategies. The insurer's organization and accountability structures need to be aligned with its strategies for successful execution.
3.0 ASSESSING THE RISK PROFILE OF THE INSURER

3.1 Steps to Assessing the Risk Profile

Assessing the risk profile of an insurer is a dynamic process comprising the following steps:

- Identifying Significant Activities;
- Assessing key risks inherent in each Significant Activity;
- Assessing Operational Management, Corporate Governance and Oversight for each Significant Activity;
- Assessing residual risk in each Significant Activity;
- Assessing Overall Residual Risk for all Significant Activities;
- Assessing the effectiveness of the Overall Governance and Risk Management functions;
- Assessing Capital and Earnings; and
- Assessing the Risk Profile of the insurer.

The above steps are interrelated and operate in a dynamic manner. They represent building blocks for assessing the risk profile of an insurer. The quality of assessment in each step can impact the quality of the assessments in the steps that follow, ultimately impacting the quality of the overall assessment. Hence, it is important that each step is carried out at an appropriate level of quality for a sound overall assessment of the insurer's risk profile.

A risk matrix is used to summarize the assessments made through the supervisory process (See appendix A). The risk matrix highlights the insurer’s Significant Activities, key risks inherent in those activities, how well the key risks are managed and overseen, residual risk in all of its Significant Activities taken together, adequacy of its capital supported by earnings, and the risk profile of the insurer as well as its direction and stability. The risk matrix provides a one page window into the insurer's operations and facilitates visualization of the components that are the key drivers of the insurer's risk profile. Assessments recorded in the risk matrix are supported by supervisory documentation.
3.2 Identifying Significant Activities

An insurer’s activities can include a line of business, business unit or an enterprise-wide process (such as information technology or asset-liability management). Its activities can be identified from various sources of information, including its organization structure, strategic and business plans, capital allocations, internal and external financial reporting.

Once an insurer’s activities are identified, sound judgement is applied in determining the significance or materiality of the activities. Materiality for this purpose is a measure of the relative significance of the activities to the attainment of the insurer’s objectives (i.e. if the activity is not well managed, there is a significant risk to the insurer in terms of it meeting its goals). It is multi-dimensional, current and prospective view and considers both qualitative and quantitative factors.

The following are examples of criteria that may be used for determining the impact of significant activities:

- assets generated by the activity in relation to total assets;
- revenue generated by the activity in relation to total revenue;
- net income before tax for the activity in relation to total net income before tax;
- risk-weighted assets generated by the activity in relation to total risk-weighted assets;
- insurance underwriting exposure in relation to capital;
- reserves held as a percentage of total reserves; and
- strategic importance.

Impact is assessed as Low (L), Medium (M), High (H). The definition of the risk ratings are noted in table 3.1 below.

<table>
<thead>
<tr>
<th>Table 3.1: Impact Ratings of Significant Activities</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Low (L)</strong></td>
</tr>
<tr>
<td>Activities have negligible effect on the organisation’s ability to function soundly.</td>
</tr>
<tr>
<td><strong>Medium (M)</strong></td>
</tr>
<tr>
<td>Activities have moderate effect on the organisation’s ability to remain profitable, liquid and solvent.</td>
</tr>
<tr>
<td><strong>High (H)</strong></td>
</tr>
<tr>
<td>Activities have significant effect on the organization’s ability to remain profitable, liquid and solvent.</td>
</tr>
</tbody>
</table>

Activities identified as significant would generally parallel those considered significant by management and how they are organized and managed by the insurer. It may be appropriate to group or sub-divide activities for efficient and effective assessment. However, in doing so, supervisors need to ensure that key risks in the activities are not masked and would be assessed at an appropriate level.

Once activities considered significant (i.e. Significant Activities) for assessing the risk profile of the insurer are identified, risks inherent in those activities are assessed.

3.3 Assessing Risks Inherent in Significant Activities

Inherent risk is a risk which cannot be segregated from the activity. It is intrinsic to an activity and arises from exposure to and uncertainty from potential future events. Inherent risk is evaluated by
considering the degree of probability and the potential size of an adverse impact on an institution's capital or earnings.

A thorough understanding of the environment in which an insurer operates and its various business activities is essential to effectively identify and assess risks inherent in its activities. For assessment purposes, inherent risks are grouped in the following categories:

3.3.1 Credit Risk
Credit risk arises from a counterparty's inability or unwillingness to fully meet its on- and/or off-balance sheet contractual obligations. Exposure to this risk results from financial transactions with a counterparty including issuer, debtor, borrower, agent or broker, policyholder, reinsurer or guarantor.

3.3.2 Market Risk
Market risk arises from changes in market rates or prices. Exposure to this risk can result from market-making, dealing, and position-taking activities in markets such as interest rate, foreign exchange, equity, commodity and real estate.

Interest rate risk and foreign exchange risk are described further below:

a. Interest Rate Risk
Interest rate risk arises from movements in interest rates. Exposure to this risk primarily results from timing differences in the re-pricing of assets and liabilities, both on- and off-balance sheet, as they either mature (fixed rate instruments) or are contractually re-priced (floating rate instruments).

b. Foreign Exchange Risk
Foreign exchange risk arises from movements in foreign exchange rates. Exposure to this risk mainly occurs during a period in which the institution has an open position, both on- and off balance sheet, and/or in spot and forward markets.

3.3.3 Insurance Risk
Insurance risk arises from claims and/or policy benefits exceeding the pure premiums charged for the products.

a. Product Design and Pricing Risk
Product design and pricing risk arises from the exposure to financial loss from transacting insurance and/or annuity business where costs and liabilities assumed in respect of a product line exceed the expectation in pricing the product line.

b. Underwriting and Liability Risk
Underwriting and liability risk is the exposure to financial loss resulting from the selection and approval of risks to be insured, the reduction, retention and transfer of risk, the reserving and adjudication of claims, and the management of contractual and non-contractual product options.

3.3.4 Operational Risk
Operational risk arises from problems in the performance of business functions or processes. Exposure to this risk can result from deficiencies or breakdowns in internal
controls or processes, technology failures, human errors or dishonesty and natural catastrophes.

3.3.5 Liquidity Risk

Liquidity risk arises from an institution's inability to purchase or otherwise obtain the necessary funds, either by increasing liabilities or converting assets, to meet its on- and off-balance sheet obligations as they come due, without incurring unacceptable losses.

3.3.6 Legal and Regulatory Risk

Legal and regulatory risk arises from an insurer's non-conformance with laws, rules, regulations, prescribed practices, or ethical standards in any jurisdiction in which the institution operates. This includes non-compliance with requirements for market conduct, anti-money laundering and counter financing of terrorism.

3.3.7 Strategic Risk

Strategic risk arises from an insurer’s inability to implement appropriate business plans, strategies, decision-making, resource allocation and its inability to adapt to changes in its business environment.

An insurer’s Significant Activities are likely to have a number of the risks noted above. However, since the inherent risk assessments are in the context of assessing the risk profile (safety and soundness) of the insurers, supervisory assessments are focused on risks that are likely to have a material impact on the insurer’s risk profile; i.e. key risks in its Significant Activities.

Key risks are assessed without regards to the impact of the activity on the insurers business and without considering the effect of risk mitigation by the insurer. The assessment is dynamic and forward looking. The impact of the activity on the insurers business is considered separately in assessing Overall Residual Risk in all of the insurer's Significant Activities taken together.

The levels of key inherent risks are assessed as Low (L), Moderate (M), Above Average (AA) or High (H). The definitions are noted in table 3.2 below.

<table>
<thead>
<tr>
<th>Table 3.2: Inherent Risk Ratings in Significant Activities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low (L)</td>
</tr>
<tr>
<td>Moderate (M)</td>
</tr>
<tr>
<td>Above Average (AA)</td>
</tr>
<tr>
<td>High (H)</td>
</tr>
</tbody>
</table>
The assessment of the level of key risks inherent in an insurer’s Significant Activities enables a supervisor to build expectations of the type and rigour of risk management and controls that would be required by the insurer to effectively manage the key risks down to acceptable levels. This, in turn, equips the supervisor to assess the quality of the insurer’s risk management and controls in the context of the key risks inherent in its activities. The higher the level of inherent risks, the more rigorous the day to day management and oversight are expected to be.

3.4 Assessing Operational Management, Corporate Governance and Oversight.

The quality of risk management and controls for each Significant Activity is assessed at two levels:

- An assessment of the day to day management of the Significant Activity (Operational or financial reporting Management); and
- An assessment of the Corporate Governance and Oversight for the Significant Activity.

3.4.1 Operational Management

Operational Management is primarily responsible for the day to day management of a Significant Activity. This function ensures that policies, processes, control systems, staff levels and experience are sufficient and effective in managing and mitigating the key risks inherent in the Significant Activity. The organization structure and controls must be effective in preventing and detecting material errors and irregularities in a timely manner.

The degree to which an insurer's Operational Management for a Significant Activity needs to be assessed directly depends on the assessment of the effectiveness of its Corporate Governance and Oversight functions. In cases where Corporate Governance and Oversight functions are assessed as effective, supervisors would be able to use the results of the work carried out by these functions in respect of the activity as input into the assessment of the effectiveness of Operational Management for the activity. Where insurers lack some or all of the Corporate Governance and Oversight functions (e.g. in case of branches), supervisors look to other functions, within or external to the insurer, that handle these responsibilities.

3.4.2 Internal Controls on Financial Reporting

Internal Control over Financial Reporting (ICFR) is meant to ensure the integrity of the financial statements and guard the assets of the company. The company should establish and develop appropriate policies and procedures to:

a) Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles.

b) Ensure the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the company.

c) Ensure Receipts and expenditures of the company are being made only in accordance with management's and the directors' approval.

d) Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

3.4.3 Corporate Governance and Oversight

The presence and nature of Corporate Governance and Oversight functions vary based on the size, structure and complexity of an insurer.
Insurers incorporated in The Bahamas are required by legislation to have a Board of Directors and Senior Management. In branches of insurers incorporated outside The Bahamas, the Principal Representative generally carries out the role and responsibilities of Senior Management.

The Board of Directors is ultimately accountable for the management and oversight of an insurer. The Board normally delegates management and oversight responsibilities to Senior Management. Depending on the size and complexity of the insurer, Senior Management, in turn, may delegate some of its oversight responsibilities to other oversight functions. Oversight functions normally set up by insurers in The Bahamas include Internal Audit, Compliance and Risk Management.

Senior Management retains the responsibilities not delegated to oversight functions. In smaller insurers, Senior Management sometimes performs responsibilities normally carried out by Operational Management. In these cases, the insurer will need to demonstrate how independent oversight is provided over these responsibilities.

In cases where an insurer lacks some of the Corporate Governance and Oversight functions (e.g. in case of branches of foreign insurers), supervisors look to other functions within or external to the insurer that handle the oversight responsibilities. Operational Management, Internal Controls on Financial Reporting, Corporate Governance and Oversight functions are assessed as Strong (S), Acceptable (A), Needs Improvement (NI) or Weak (W). The definitions for the risk ratings with respect to these functions are noted at table 3.3 below. The ICB has developed assessment criteria for the relevant Senior Management, Board and Oversight functions. The assessment criteria serve as a guide for supervisory judgement. The assessment criteria are available on the ICB website.

<table>
<thead>
<tr>
<th><strong>Table 3.3: Performance Rating for Operational Management, Internal Controls on Financial Reporting, Corporate Governance and Oversight functions</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Strong (S)</strong>, The control function consistently demonstrates high effective characteristics and is superior to generally accepted industry standard. The control functions exhibit the strongest performance and risk management practices relative to the institution's size, complexity, and give no cause for supervisory concern.</td>
</tr>
<tr>
<td><strong>Acceptable (A)</strong>, The control function consistently demonstrates effective performance and meets generally accepted industry standards. The control function has overall satisfactory risk management practices, are satisfactory relative to the institution's size and complexity and give no material supervisory concerns and, as a result, the supervisory response is informal and limited.</td>
</tr>
<tr>
<td><strong>Needs Improvement (NI)</strong>, Needs improvement means that the function may generally demonstrate effective performance, but there are some areas where effectiveness is</td>
</tr>
</tbody>
</table>

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needs to be improved in the context of the key risks inherent in the Significant Activity.

**Weak (W)**

The control function has demonstrated serious instances where effectiveness needs to be improved through immediate action; characteristics and performance do not meet generally accepted industry standards. The control function contains inadequate risk management practices relative to the institution’s size and complexity and requires the greatest of supervisory concern. Ongoing supervisory attention is necessary.

### 3.5 Assessing Residual Risk in each Significant Activity

The assessment of the residual risk in each Significant Activity considers the extent to which the key risks inherent in the activity are effectively managed by Operational Management, ICFR and independently overseen by Corporate Governance and Oversight functions. For each Significant Activity the effectiveness and oversight of each key inherent risk is considered separately and then compiled into an assessment of the residual risk for the activity. Hence, these assessments are multi-dimensional and are based on informed qualitative judgements.

For example, an insurance activity may be assessed as having a high insurance risk, and a moderate level of operational risk. However, the residual risk for the activity may be assessed as moderate due to an acceptable level of risk management by Operational Management and a strong oversight by Internal Audit and Senior Management and an acceptable level of oversight by the Board.

Net residual risk for an activity is assessed as **Low (L), Moderate (M), Above Average (AA) or High (H)**. The risk ratings for Net Residual Risk in significant activities are noted in table 3.4 below.

<table>
<thead>
<tr>
<th>Table 3.4: Risk Ratings for Residual Risk in Significant Activities</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Low (L)</strong></td>
</tr>
<tr>
<td><strong>Moderate (M)</strong></td>
</tr>
<tr>
<td><strong>Above Average (AA)</strong></td>
</tr>
<tr>
<td><strong>Weak (W)</strong></td>
</tr>
</tbody>
</table>
Significant Activity has an above average probability of a material adverse impact on its capital and earnings in the foreseeable future.

High (H)  The insurer has weaknesses in its risk management that may pose a serious threat to its financial viability or solvency and give rise to high residual risk in a Significant Activity. As a result, residual risks in the Significant Activity has a high probability of a material adverse impact on its capital and earnings in the foreseeable future.

The following table is used to guide the residual risk net risk assessments.

<table>
<thead>
<tr>
<th>Aggregate Quality of Risk Management for a Significant Activity</th>
<th>Level of Inherent Risk</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Low</td>
</tr>
<tr>
<td>Nett Risk Assessment</td>
<td>Strong</td>
</tr>
<tr>
<td></td>
<td>Low</td>
</tr>
<tr>
<td></td>
<td>Moderate</td>
</tr>
<tr>
<td></td>
<td>Above Average</td>
</tr>
</tbody>
</table>

The residual risk net risk assessments include a determination of the direction of residual risk. Direction is assessed as Decreasing (D), Stable (S), or Increasing (I) over an appropriate time horizon for the insurer. The direction is based on an assessment of macro and micro prudential trends.

### 3.6 Assessing Overall Residual Risk for all Significant Activities

Overall Residual Risk of all Significant Activities taken together is a weighted aggregate of the residual risk of the individual Significant Activities. The assessment considers the residual risk in each activity and its impact rating in developing the overall assessment. The overall assessment is a qualitative assessment of the insurer's susceptibility to adverse events that might impact its earnings or capital in the foreseeable future.
Overall Residual Risk is rated as **Low (L)**, **Moderate (M)**, **Above Average (AA)** or **High (H)**. The direction of Overall Residual Risk is assessed as **Decreasing (D)**, **Stable (S)**, or **Increasing (I)**.

### 3.7 Assessing Earnings and Capital

After assessing the Overall Residual Risk in an insurer’s Significant Activities, supervisors assess Earnings and Capital in the context of the Overall Residual Risk. Under the methodology, Earnings and Capital are first assessed separately to understand how they individually contribute to the safety and soundness of the insurer, and then considered together to assess their adequacy in the context of the Overall Residual Risk in the insurer’s Significant Activities.

Earnings and Capital are assessed as **Strong (S)**, **Acceptable (A)**, **Needs Improvement (NI)** or **Weak (W)**. The criteria used to assess Earnings and Capital are summarized below:

#### 3.7.1 Earnings

Earnings are intended to provide for an insurer’s expected losses, generate an adequate return for the shareholders and contribute to capital.

The assessment of earnings considers the quality, quantity, volatility and sustainability of earnings in the context of the insurer’s business objectives and its Overall Residual Risk. It also considers historical trends and future outlook, both under normal and stressed conditions, as well as reliability of its contribution to capital.

#### 3.7.2 Capital

Capital represents resources of an insurer to enable it to withstand unexpected losses and shocks (i.e. it is an insurer’s safety net.).

The assessment of capital considers the adequacy of capital (quality and quantity) both at present and prospectively and under normal and stressed conditions in the context of the insurer’s Overall Residual Risk. It also considers capital management processes and access to capital in the context of the insurer’s Overall Residual Risk and planned business activities. It is not sufficient for an insurer to merely meet minimum regulatory requirements. Capital has to be sufficient to support the risk profile of the insurer as well as its planned activities. Also, no matter how substantial an insurer's capital is, it cannot be considered a substitute for appropriate risk management and oversight of the insurer’s activities.

### 3.8 Assessing the Risk Profile of the Insurer

The assessment of the risk profile is an overall assessment of the insurer after considering the adequacy of its capital, supported by earnings, in the context of the Overall Residual Risks in its Significant Activities. It is an assessment of the safety and soundness of the insurer.

The risk profile is assessed as **Low (L)**, **Moderate (M)**, **Above Average (AA)** or **High (H)**. The assessment also includes an assessment of the direction of the insurer’s risk profile. Direction is assessed as **Decreasing (D)**, **Stable (S)** or **Increasing (I)**. The assessment ratings are noted at table 3.8 below.

| Table 3.8: Assessment Rating of Insurer’s Risk Profile |
## Low (L)
A strong, well-managed insurer. The combination of its Overall Residual Risk and its capital and earnings makes the insurer resilient to most adverse business and economic conditions without materially affecting its risk profile. Its performance has been consistently good, with most key indicators in excess of industry norms, allowing it ready access to additional capital. Any supervisory concerns have a minor effect on its risk profile and can be addressed in a routine manner.

Normally, an insurer in this category would have a low Overall Residual Risk coupled with acceptable capital and earnings, or a moderate Overall Residual Risk coupled with strong capital and earnings. Other combinations may be possible depending on the circumstances of the insurer.

## Moderate (M)
A sound, generally well-managed insurer. The combination of its Overall Residual Risk and its capital and earnings makes the insurer resilient to normal adverse business and economic conditions without materially affecting its risk profile. The insurer's performance is satisfactory, with key indicators generally comparable to industry norms, allowing it reasonable access to additional capital. Supervisory concerns are within the insurer's ability to address.

Normally, an insurer in this category would have moderate Overall Residual Risk coupled with acceptable capital and earnings, or low Overall Residual Risk coupled with capital and earnings that need improvement. Other combinations may be possible depending on the circumstances of the insurer.

## Above Average (AA)
The insurer has issues that indicate an early warning or that could lead to a risk to its financial viability. One or more of the following conditions are present. The combination of its Overall Residual Risk and its capital and earnings makes the insurer vulnerable to adverse business and economic conditions. Its performance is unsatisfactory or deteriorating, with some key indicators at or marginally below industry norms, impairing its ability to raise additional capital. The insurer has issues in its risk management that, although not serious enough to present an immediate threat to financial viability or solvency, could deteriorate into serious problems if not addressed promptly.

Normally, an insurer in this category would have above average Overall Residual Risk, which is not sufficiently mitigated by capital and earnings, or moderate Overall Residual Risk coupled with capital and earnings that need improvement. Other combinations may be possible depending on the circumstances of the insurer.

## High (H)
The insurer has serious safety and soundness concerns. One or more of the following conditions are present. The combination of its Overall Residual Risk and its capital and earnings is such that the insurer is vulnerable to most adverse business and economic conditions, posing a serious threat to its financial viability or solvency unless effective
corrective action is implemented promptly. Its performance is poor, with most key indicators below industry norms, seriously impairing its ability to access additional capital.

Normally, an insurer in this category would have high Overall Residual Risk, which is not sufficiently mitigated by capital and earnings, or above average Overall Residual Risk with capital and earnings that need improvement. Other combinations may be possible depending on the circumstances of the insurer.

Direction is assessed as Decreasing (D), Stable (S), or Increasing (I) based on an overall assessment of macro and micro prudential trends for the insurer informed by the direction assessed for individual significant activities and assessment of capital and earnings.

The supervisory methodology provides for a baseline level of activity to assess the risk profile of each insurer. It also provides the basis from which to determine risk based priorities and the level of intervention considered necessary in individual cases. Once an insurer’s risk profile has been assessed it is refreshed through a dynamic assessment of the impact of any material changes on the insurer’s risk profile. Accordingly, beyond this dynamic monitoring and up-dating of an insurer’s risk profile, ICB’s supervisory resources focus on insurers that require attention based on their risk profile and the prudential issues that need to be addressed.
4.0 RISK ASSESSMENT AND THE SUPERVISORY PROCESS

4.1 The Supervisory Cycle

ICB appoints a responsible officer (RO) for each insurer. The RO is the key contact at ICB for the insurer and is responsible for the on-going supervision of the insurer and ensuring that supervisory processes are completed effectively and on a timely basis.

The main steps of the supervisory process are illustrated below. Although the steps are described sequentially, updating of the risk assessment is a dynamic and iterative process requiring frequent reassessments at various stages of the process.

4.1.1 Monitoring and Analysis

Results of monitoring and analysis of an insurer are primary inputs into the risk assessment process. Supervisors are responsible for ongoing analysis and monitoring (off-site supervision) of insurers.

Monitoring and analysis includes a review of company information and comparative analysis (both historical and against peers) of the results of early warning tests and ratios to identify outliers and considers the probable impact of any material changes in the operating environment. It also includes meetings with key individuals at the insurer to discuss trends and emerging issues. The scope of the work depends on the size, complexity and the risk profile of the insurer.

Financial condition and performance of insurers is monitored and analyzed regularly for all insurers and more frequently for higher risk insurers. Results of the monitoring and analysis are used to update the risk profile of the insurer and provide the context for planning on-site supervision of the insurer.

4.1.2 Planning

A supervisory plan is prepared annually for each insurer and outlines the nature and scope of monitoring and on-site supervisory work planned and resources required. The nature
and scope of the work planned is based on the risk profile of the insurer and the nature of prudential issues to be addressed. The focus is on the activities and risk management processes identified as significant risk areas and on areas where the risk assessment is likely to have changed because of the changes within and external to the insurer or where information needs to be updated.

A supervisory plan is responsive to unforeseen events that may alter the risk profile of the insurer. Revising a plan requires a reassessment of priorities, not just an extension of the scope of the supervisory efforts.

4.1.3 On-site Reviews

On-site reviews are a critical part of the supervisory process. The scope of on-site reviews depends on the risk profile of the insurer and the nature of prudential concerns, if any. These reviews and interactions with the insurer’s management and oversight functions also enhance ICB’s understanding of the insurer and its risk profile.

4.1.4 Documentation

Effective supervision requires a sufficiently deep understanding of an insurer. This understanding is acquired over time through monitoring, analysis and on-site reviews as well as through interactions with management and oversight functions of the insurer. Hence, it is critical that knowledge acquired through the supervisory process be captured and built over time. Utility of this knowledge across ICB increases if it is captured using a standard structure.

Documentation is key to supporting supervisory judgment in assessing insurers' risk profile and quality assurance of supervisory work. ICB has developed a standard format to capture the analysis and assessments of Significant Activities and Corporate Governance and Oversight functions of individual insurers. The assessments captured are supported by additional working papers. Once the initial assessments of Significant Activities and Corporate Oversight and Governance functions are captured, future changes are incorporated by updating the original documents which makes the process more efficient.

4.1.5 Reporting

Supervisors prepare a Management Report, at least annually, to insurers to communicate ICB’s overall assessment of the insurer’s risk profile, any prudential concerns identified and recommendations for addressing them. It is the key written document sent to the institution. In the case of on-site reviews, the final stage of the process includes issuing a Management Report.

Assessments, findings and recommendations are first discussed with appropriate senior managers of the insurer. This is followed by reporting to the Chief Executive Officer (CEO) and the Board (Audit Committee).

Management Reports to companies incorporated in The Bahamas are addressed to the CEO and copied to the Chair of the Audit Committee. Management Reports to foreign insurers operating branches in The Bahamas are addressed to the Principal Representative of the branch. Where there are significant issues with a branch, a copy of the Management Report may be sent to the CEO and the Chair of the Audit Committee at the home office. In all cases, the covering letter requests that a copy of the Management Report be provided to the external auditors and to the actuary (where applicable).
4.1.6 Follow-up

Prudential concerns identified are monitored by supervisors for timely resolution by the insurer.
5.0 INTERVENTION PROCESS

5.1 SUPERVISORY INTENSITY AND INTERVENTION

The intensity of supervision will depend on the nature, size, complexity and risk profile of an insurer. Where there are identified risks or areas of concern, the degree of intervention will be commensurate with the risk assessment and in accordance with the Supervisory Ladder of Intervention for Insurance Companies (see separate document).

The Ladder of Intervention (LOI) provides a framework for remedial supervisory intervention for all insurance companies supervised by the ICB. This framework has two key purposes. First, it will support the early identification of risks to a firm’s viability and ensure that firms take appropriate remedial action to reduce the probability of failure. Second, it will flag actions that ICB will need to take in advance to prepare for the resolution of a firm. The more high risk a firm’s risk profile the more advanced the supervisory intervention activities.

The table below shows the likely alignment between the composite risk ratings and the intervention ratings.

<table>
<thead>
<tr>
<th>Composite Risk Rating</th>
<th>Intervention Stage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low (L)</td>
<td>Stage 0 Normal Activities</td>
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<tr>
<td>Moderate (M)</td>
<td>Stage 0 Normal Activities</td>
</tr>
<tr>
<td></td>
<td>Stage 1 Early Warning</td>
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<tr>
<td>Above Average (AA)</td>
<td>Stage 1 Early Warning</td>
</tr>
<tr>
<td></td>
<td>Stage 2 Risk to Financial Viability or Solvency</td>
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<tr>
<td>High (H)</td>
<td>Stage 2 Risk to Financial Viability or Solvency</td>
</tr>
<tr>
<td></td>
<td>Stage 3 Future financial Viability in serious doubt</td>
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<td></td>
<td>Stage 4 Non-viability</td>
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</tbody>
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## Appendix A – Risk Matrix

<table>
<thead>
<tr>
<th>Name of Institution</th>
<th>Assessment as at</th>
<th>Supervisor</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>IMPACT - L/M/H – Low/ Moderate / High</td>
<td>Manager</td>
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<tr>
<td></td>
<td>INHERENT RISKS – risks before mitigation</td>
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<td>IMPACT - L/M/H – Low/ Moderate / High</td>
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<td></td>
<td>INHERENT RISKS – risks before mitigation</td>
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<tr>
<td></td>
<td>RISK MANAGEMENT</td>
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<td></td>
<td>CORPORATE GOVERNANCE AND OVERSIGHT</td>
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<td></td>
<td>Other Enterprise - wide Risk Management Functions</td>
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</tr>
<tr>
<td></td>
<td>NET RISK ASSESSMENT</td>
<td>Direction: Increasing/ Decreasing / Stable</td>
</tr>
</tbody>
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**Impact**
- L Lower than average
- M Average (Moderate)
- AA Above Average
- H High

**Inherent Risks**
- L/M/AA or H probability of a material adverse impact on an insurer’s capital or earnings due to exposure and uncertainty from potential future events

**Risk Management**
- S Strong
- A Acceptable
- NI Needs Improvement
- W Weak

**Corporate Governance and Oversight**
- S Strong
- A Acceptable
- NI Needs Improvement
- W Weak

**Other Enterprise-wide Risk Management Functions**
- "Other"

**Net Risk Assessment**
- L Lower than average
- M Average (Moderate)
- AA Above Average
- H High

**Overall Rating**

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**Overall Rating**

<table>
<thead>
<tr>
<th>CAPITAL</th>
<th>EARNINGS</th>
<th>COMPOSITE RISK RATING</th>
<th>DIRECTION</th>
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