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THE WAIT IS OVER:
THE UAE INSURANCE AUTHORITY'S NEW FINANCIAL REGULATIONS

On 28 December 2014, the United Arab Emirates (UAE) Insurance Authority issued the long awaited financial regulations for conventional insurance companies and takaful insurance companies[1] (the Financial Regulations). The Financial Regulations, which are largely in line with the "Draft Combined Regulations" issued by the Insurance Authority in December 2013, set out the regulatory requirements in relation to investment limits, capital, solvency, technical provisions, record keeping and accounting requirements.

The existing UAE Insurance Law and its implementing regulations required insurers to comply with minimum capital requirements, including a security deposit and a minimum guarantee fund. However, very little detail was provided as to the calculation of such requirements. The Financial Regulations therefore mark a new era in insurance regulation in the UAE with a move to a more complex and risk-based approach to prudential regulation of the UAE insurance market.

The Financial Regulations were subsequently published in the UAE Official Gazette No. 575 on 28 January 2015 and came into force on 29 January 2015. However, insurers are given a grace period of between one to three years to comply with the Financial Regulations, depending on the section involved (considered in detail below).

Capital, Solvency Margin and Minimum Guarantee Fund

The minimum capital requirements remain at AED 100 million for insurers and AED 250 million for reinsurers. In addition, the Financial Regulations now require that:

- Insurers maintain a minimum guarantee fund, which is not less than one third of the Solvency Capital Requirement.
- Insurers calculate their solvency margin using the template developed and amended by the UAE Insurance Authority.

1 Insurance Authority Board of Directors' Decision No. 25 of 2014 Pertinent to Financial Regulations for Insurance Companies and Insurance Authority Board of Directors' Decision No. 26 of 2014 Pertinent to Financial Regulations for Takaful Insurance Companies.

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- An insurer's Solvency Capital Requirement takes into account underwriting risk, market and liquidity (investment) risk, credit risk and operational risk.

These requirements are broadly in line with the proposals under Europe's Solvency II, which, for example, also requires that one third of the required solvency margin shall constitute the guarantee fund. However, the Insurance Authority has yet to release the template for the calculation of solvency margins and so the extent of the parallels with Solvency II are not fully clear.

Insurers are required to comply with the requirements in relation to Solvency Margin and Minimum Guarantee Fund within three years (i.e. by 29 January 2018). The Financial Regulations require insurers to notify the Insurance Authority immediately in the event of non-compliance with the Minimum Capital, Solvency Capital Requirement or Minimum Guarantee Fund.

Investment of policyholder rights and insurer's assets

The Financial Regulations impose a broad obligation on insurers to ensure that *"all assets, in particular those covering Minimum Capital Requirement, Minimum Guarantee Fund and the Solvency Capital requirement, shall be invested in such a manner to ensure the security, quality, liquidity and profitability of the portfolio as a whole"*, then set out specific restrictions on investments. Insurers are required to ensure that their assets are diversified and in compliance with new limits in respect of aggregate exposures in individual asset classes and sub-limits for exposures to a single counterparty.

Broadly speaking, Section 1 sets the limits on investments and counterparty limits whilst Section 4 provides details of how assets will be valued.

Figure 1: New limits in respect of aggregate exposures in individual asset classes and sub-limits for exposures to a single counterparty:

Type of invested asset	Maximum limit for aggregate exposure in a particular asset class	Sub-limit for exposure to a single counter-party
Real estate (at market value).	30%	None
Equity instruments in listed and not listed companies within UAE.	30%	10%
Equity instruments issued by companies listed and not listed outside UAE.	20%	10%
Government securities/instruments issued by the UAE and/or by one of the Emirates in the UAE.	100%	25%
Government securities/instruments issued by (A) rated countries.	80%	25%
Cash and deposits with banks in the UAE (e.g. current account, demand deposits, term deposits, notice deposits, certificates of deposit, etc.).	5% minimum	50%
Loans secured by life policies (excluding unit-linked funds' related policies) issued by the company.	30%	None
Derivatives or complex financial instruments used for hedging purposes only.	1%	None
Secured loans, deposits with non-banks, debentures, bonds & other debt instruments which are rated strong or very strong by reputed and independent rating agency.	30%	20%
Other invested assets.	10%	None

Additional requirements apply in Section 4 in relation to "assets held in respect of life insurance contracts where the investment risk is borne by the policyholders". In such cases, insurers must ensure that:

- Where the benefits provided by a contract are directly linked to the value of unit-linked funds, or to the value of assets contained in an internal fund held by the insurer, the technical provisions with respect to those benefits must be represented as closely as possible by those units or assets.
- Where the benefits provided by a contract are directly linked to a share index or some other reference value, the technical provisions with respect to those benefits must be represented as closely as possible either by the units deemed to

represent the reference value or, in the case where units are not established, by assets of appropriate security and marketability which correspond as closely as possible with those on which the particular reference value is based.

- Where the benefits include a guarantee of investment performance or some other guaranteed benefit, the assets held to cover the corresponding additional technical provisions shall be invested in such a manner to ensure the security, quality, liquidity and profitability of the portfolio as a whole.

The Financial Regulations also impose new restrictions in relation to the domicile of investments. Insurers operating in the UAE are permitted to hold assets for UAE liabilities in a foreign jurisdiction with a sovereign rating which is better or at least equivalent to the sovereign rating of the UAE. Total invested assets held outside the UAE must not exceed 50% of the total invested assets or 100% of the total technical provisions for policies outside the UAE only (excluding unit-linked funds), whichever is greater.

Insurers licensed in the UAE must therefore restructure their investment portfolios to comply with the new requirements within the following timeframes:

- Within three years for investments in real estate assets (i.e. by 29 January 2018).
- Within two years for investments in non-real estate assets (i.e. by 29 January 2017).
- Within three years in relation to assets held in respect of life insurance contracts.

There is no doubt that some insurers, particularly small to medium firms, currently operating in the UAE may find the new requirements costly and difficult to comply with.

Asset valuation

Valuations must, where possible, be on a "mark to market" basis. There are additional detailed requirements in relation to the valuation of assets generally, including, for example, specific requirements in relation to the valuation of real estate assets; one independent real estate firm shall value real estate assets less than AED 30 million, while two independent real estate firms are required for the valuation of real estate assets over AED 30 million.

Insurers must also undertake annual stress testing in respect of their investments. This includes a requirement for regular stress testing for a range of market scenarios and changing investment and operating conditions, like socio-economic or regulatory changes, in order to assess the appropriateness of asset allocation limits.

Governance

Insurers must put in place investment and risk management policies which are reviewed and approved on an annual basis by the company's Board of Directors. Importantly, insurers are now required to have a Board level Investment Committee which must have its own charter, investment policy and guidelines approved by the Board of Directors.

While an insurer can outsource the management of the insurer's investment policy to third parties, the insurer remains ultimately responsible for the activities of the third party. Further, insurers must monitor the performance of the third party at least annually and take appropriate action if investment returns to policyholders are adversely affected.

Insurers are also required to provide the Insurance Authority with:

- Quarterly reports in relation to its investment portfolio within 45 days of quarter end.
- Annual risk analysis reports in respect of its investments, to be submitted with the insurer's annual audited financial accounts.

Insurers must also have in place an effective risk management framework which takes into account underwriting risk, market and liquidity (investment) risk, credit risk and operational risk, each of which are described in more detail in Section 1 of the Financial Regulations. Insurers must comply with the new governance requirements in Section 1 within two years (i.e. by 29 January 2017).

Calculation of technical provisions

Section 3 of the Financial Regulations sets out detailed guidelines in relation to the calculation of technical provisions by insurers, namely, unearned premium reserves, unexpired risk reserves, outstanding loss reserves, incurred but not reported reserves, allocated loss adjustment expense and unallocated loss adjustment expense reserves and mathematical reserves.

Significantly, all insurers must appoint an actuary who is registered with the Insurance Authority to review and approve the insurer's technical provisions. Insurers must report quarterly to the Insurance Authority in relation their technical provisions. Further, insurers must submit annual reports to the Insurance Authority which have been certified by the actuary, authenticated by the external auditor and endorsed by the insurer's Chairman. The Financial Regulations also set out the minimum content that must be contained in an actuary's annual report which is to be provided to the Insurance Authority.

Insurers must comply with the requirements in Section 3 of the Financial Regulations within two years (i.e. by 29 January 2017). We expect that insurers will face challenges in relation to the appointment of a registered actuary, as the Insurance Authority's website currently lists only 28 registered actuaries.

Record keeping and reporting obligations

Sections 5 and 6 of the Financial Regulations impose extensive obligations on insurers in relation to the maintenance of books and records, and the provision of such books and records to the Insurance Authority. Essentially, insurers must maintain complete transaction records for all local and international operations. The new regulations help to clarify the record keeping obligations which were already referred to in the Insurance Law and its Implementing Regulations by:

- Providing a complete list of all records to be maintained.
- Confirming that such records must be maintained for 10 years from the end of financial year, or the end of activity or relationship with the insured.
- Confirming that electronic information, fax and email records are adequate for record keeping purposes.

Insurers must also maintain a back-up of all records at a separate location from the original records. Insurers must ensure that their operations comply with the new record keeping obligations within one year (i.e. by 29 January 2016).

Audit function

Each insurer must also:

- Establish an Audit Committee consisting of at least three members from the insurer's non-executive managers (a Chairman and two other members), of whom one member shall be an expert in financial and accounting affairs.
- Establish an internal audit function, which oversees risk management and governance and regularly reports to the Audit Committee in relation to risk management or governance issues.
- Appoint a regulatory compliance officer who is required to verify the company's compliance with all rules, regulations and instructions. The regulatory compliance officer shall directly report to the Chief Executive Officer and can contact the Insurance Authority directly. It is not clear whether or not the regulatory compliance officer required to be appointed under the Financial Regulations can also act as the "discipline officer" which each insurer is required to appoint under the Insurance Authority's Anti-Money Laundering Regulations[2].

Insurers must appoint an independent external auditor to review and report on the company's accounts each financial year and to undertake additional functions as requested by the Insurance Authority, including notifying the Insurance Authority of any financial violations discovered during the course of the audit or of any reservations regarding the accounts or the reserves of the insurer.

Insurers must ensure that their audit arrangements comply with the Financial Regulations within one year (i.e. by 29 January 2016).

Financial reporting

An insurer's financial statements must be prepared in accordance with the International Financial Reporting Standards and the Insurance Authority's prescribed forms contained in the Financial Regulations.

Section 7 of the Financial Regulations also requires insurers to submit annual and quarterly financial reports to the Insurance Authority. Annual financial and closing statements must be submitted to the Insurance Authority in Arabic and English while quarterly financial statements must be submitted to the Insurance Authority in Arabic (English translations being optional).

Insurers must comply with the financial reporting requirements within one year (i.e. by 29 January 2016).

HFW comment

The new prudential requirements prescribed by the Financial Regulations are broadly similar to the risk-based prudential requirements being imposed in Europe under Solvency II. Further, the requirements in relation to governance, record keeping, and reporting obligations reflect international standards and good corporate practice. Therefore, the Financial Regulations usher in a more sophisticated era of regulation for the UAE insurance industry, which to date has had little by way of guidance on such matters.

The Financial Regulations will generally provide better protection to policyholders and shareholders by placing greater regulatory oversight in respect of the capital, solvency and investment activities of insurance companies in the UAE.

The application of the Financial Regulations to branches of foreign insurers operating in the UAE is also

2 Insurance Authority Board of Directors' Resolution No. 16 of 2013 Concerning Instructions on Anti-money Laundering and Counter-Terrorism Financing Procedures in Insurance Activities.

Figure 2

Section of Financial Regulations	Timeframe for compliance
Capital, solvency, margin and minimum guarantee fund.	29 January 2018
Investment of policyholder rights and insurer's assets and asset valuation.	29 January 2018 (real estate assets and life insurance contract requirements) 29 January 2017 for remaining Section 1 requirements
Governance.	29 January 2017
Calculation of technical provisions.	29 January 2017
Record keeping and financial reporting obligations.	29 January 2016
Audit function.	29 January 2016

likely to cause practical difficulties. While the Financial Regulations generally note that the requirements will only apply in respect of "UAE policies" issued by such branches, head offices will have the difficult task of separating UAE business from other business and applying different regulatory measures in respect of UAE policies.

As the Financial Regulations implement a more complex prudential regime, insurers should expect to incur greater costs, and require additional staff, in order to ensure compliance with the new requirements. We therefore expect that many of the small to medium size insurance companies which have traditionally operated in the UAE may struggle to comply with the new requirements, particularly around asset diversification and limited, thereby leading to some consolidation in the market.

That said, much will depend on how active the Insurance Authority is in the implementation and enforcement of the Financial Regulations. Historically, the enforcement regime has been relatively passive in the UAE but it would be reasonable to assume that given the extent of the changes imposed by these Financial Regulations, the Insurance Authority will begin to take a more active approach to enforcement.

While the Financial Regulations provide for phased implementation so that they do not need to be applied by insurers immediately (as discussed in relation to each section above), some of the requirements necessitate substantial changes in current operations. Therefore, insurers operating in the UAE cannot afford to be complacent and will need to ensure that they put systems in place with a view to complying with the requirements within the timeframes specified in the Financial Regulations.

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